

CAPITAL CITY BANK GROUP INC  
Form 10-Q  
May 04, 2018

**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 March 31, 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**

**59-2273542**

Edgar Filing: CAPITAL CITY BANK GROUP INC - Form 10-Q

(State or other jurisdiction of incorporation or organization)

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

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

**32301**  
(Zip Code)

**(850) 402-7821**

(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       Smaller reporting company   
(Do not check if 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 April 30, 2018, 17,044,066 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 MARCH 31, 2018**

**TABLE OF CONTENTS**

| <b>PART I – Financial Information</b> |                                                                                                        | <b>Page</b> |
|---------------------------------------|--------------------------------------------------------------------------------------------------------|-------------|
| Item 1.                               | Consolidated Financial Statements (Unaudited)                                                          |             |
|                                       | Consolidated Statements of Financial Condition – March 31, 2018 and December 31, 2017                  | 4           |
|                                       | Consolidated Statements of Income – Three Months Ended March 31, 2018 and 2017                         | 5           |
|                                       | Consolidated Statements of Comprehensive Income – Three Months Ended March 31, 2018 and 2017           | 6           |
|                                       | Consolidated Statements of Changes in Shareowners’ Equity – Three Months Ended March 31, 2018 and 2017 | 7           |
|                                       | Consolidated Statements of Cash Flows – Three Months Ended March 31, 2018 and 2017                     | 8           |
|                                       | Notes to Consolidated Financial Statements                                                             | 9           |
| Item 2.                               | Management's Discussion and Analysis of Financial Condition and Results of Operations                  | 27          |
| Item 3.                               | Quantitative and Qualitative Disclosure About Market Risk                                              | 42          |
| Item 4.                               | Controls and Procedures                                                                                | 42          |
| <b>PART II – Other Information</b>    |                                                                                                        |             |
| Item 1.                               | Legal Proceedings                                                                                      | 42          |
| Item 1A.                              | Risk Factors                                                                                           | 42          |
| Item 2.                               | Unregistered Sales of Equity Securities and Use of Proceeds                                            | 42          |
| Item 3.                               | Defaults Upon Senior Securities                                                                        | 42          |
| Item 4.                               | Mine Safety Disclosure                                                                                 | 42          |
| Item 5.                               | Other Information                                                                                      | 42          |
| Item 6.                               | Exhibits                                                                                               | 43          |
| <b>Signatures</b>                     |                                                                                                        | <b>44</b>   |



## INTRODUCTORY NOTE

### Caution Concerning Forward-Looking Statements

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

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

Our ability to achieve our financial objectives could be adversely affected by the factors discussed in detail in Part I, Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Part II, Item 1A. “Risk Factors” in this Quarterly Report on Form 10-Q and the following sections of our Annual Report on Form 10-K for the year ended December 31, 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, including the Dodd-Frank Act, Basel III, and the ability to repay and qualified mortgage standards;
- the effects of security breaches and computer viruses that may affect our computer systems or fraud related to debit card products;
- the accuracy of our financial statement estimates and assumptions, including the estimates used for our loan loss provision, 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>                                                                      | <b>(Unaudited)<br/>March 31,<br/>2018</b> | <b>December 31,<br/>2017</b> |
|----------------------------------------------------------------------------------------------------|-------------------------------------------|------------------------------|
| <b>ASSETS</b>                                                                                      |                                           |                              |
| Cash and Due From Banks                                                                            | \$ 47,804                                 | \$ 58,419                    |
| Federal Funds Sold and Interest Bearing Deposits                                                   | 250,821                                   | 227,023                      |
| Total Cash and Cash Equivalents                                                                    | 298,625                                   | 285,442                      |
| Investment Securities, Available for Sale, at fair value                                           | 471,836                                   | 480,911                      |
| Investment Securities, Held to Maturity, at amortized cost (fair value of \$222,210 and \$215,007) | 225,552                                   | 216,679                      |
| Total Investment Securities                                                                        | 697,388                                   | 697,590                      |
| Loans Held For Sale                                                                                | 4,845                                     | 4,817                        |
| Loans, Net of Unearned Income                                                                      | 1,661,895                                 | 1,653,492                    |
| Allowance for Loan Losses                                                                          | (13,258)                                  | (13,307)                     |
| Loans, Net                                                                                         | 1,648,637                                 | 1,640,185                    |
| Premises and Equipment, net                                                                        | 90,939                                    | 91,698                       |
| Goodwill                                                                                           | 84,811                                    | 84,811                       |
| Other Real Estate Owned                                                                            | 3,330                                     | 3,941                        |
| Other Assets                                                                                       | 96,257                                    | 90,310                       |
| Total Assets                                                                                       | \$ 2,924,832                              | \$ 2,898,794                 |
| <b>LIABILITIES</b>                                                                                 |                                           |                              |
| Deposits:                                                                                          |                                           |                              |
| Noninterest Bearing Deposits                                                                       | \$ 890,482                                | \$ 874,583                   |
| Interest Bearing Deposits                                                                          | 1,608,402                                 | 1,595,294                    |
| Total Deposits                                                                                     | 2,498,884                                 | 2,469,877                    |
| Short-Term Borrowings                                                                              | 4,893                                     | 7,480                        |
| Subordinated Notes Payable                                                                         | 52,887                                    | 52,887                       |
| Other Long-Term Borrowings                                                                         | 13,333                                    | 13,967                       |
| Other Liabilities                                                                                  | 66,475                                    | 70,373                       |
| Total Liabilities                                                                                  | 2,636,472                                 | 2,614,584                    |
| <b>SHAREOWNERS' EQUITY</b>                                                                         |                                           |                              |
| Preferred Stock, \$.01 par value; 3,000,000 shares authorized; no shares issued and outstanding    | -                                         | -                            |
| Common Stock, \$.01 par value; 90,000,000 shares authorized; 17,044,066 and 16,988,951 shares      | 171                                       | 170                          |

Edgar Filing: CAPITAL CITY BANK GROUP INC - Form 10-Q

issued and outstanding at March 31, 2018 and December 31, 2017,  
respectively

|                                                  |              |              |
|--------------------------------------------------|--------------|--------------|
| Additional Paid-In Capital                       | 37,343       | 36,674       |
| Retained Earnings                                | 283,990      | 279,410      |
| Accumulated Other Comprehensive Loss, net of tax | (33,144)     | (32,044)     |
| Total Shareowners' Equity                        | 288,360      | 284,210      |
| Total Liabilities and Shareowners' Equity        | \$ 2,924,832 | \$ 2,898,794 |

*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> | <b>Three Months Ended March 31,</b> |             |
|------------------------------------------------------|-------------------------------------|-------------|
|                                                      | <b>2018</b>                         | <b>2017</b> |
| <b>INTEREST INCOME</b>                               |                                     |             |
| Loans, including Fees                                | \$ 19,535                           | \$ 18,005   |
| Investment Securities:                               |                                     |             |
| Taxable Securities                                   | 2,523                               | 1,783       |
| Tax Exempt Securities                                | 239                                 | 259         |
| Federal Funds Sold and Interest Bearing Deposits     | 917                                 | 493         |
| Total Interest Income                                | 23,214                              | 20,540      |
| <b>INTEREST EXPENSE</b>                              |                                     |             |
| Deposits                                             | 868                                 | 281         |
| Short-Term Borrowings                                | 8                                   | 45          |
| Subordinated Notes Payable                           | 475                                 | 379         |
| Other Long-Term Borrowings                           | 100                                 | 99          |
| Total Interest Expense                               | 1,451                               | 804         |
| <b>NET INTEREST INCOME</b>                           | 21,763                              | 19,736      |
| Provision for Loan Losses                            | 745                                 | 310         |
| Net Interest Income After Provision For Loan Losses  | 21,018                              | 19,426      |
| <b>NONINTEREST INCOME</b>                            |                                     |             |
| Deposit Fees                                         | 4,872                               | 5,090       |
| Bank Card Fees                                       | 2,811                               | 2,803       |
| Wealth Management Fees                               | 2,173                               | 1,842       |
| Mortgage Banking Fees                                | 1,057                               | 1,308       |
| Other                                                | 1,564                               | 1,675       |
| Total Noninterest Income                             | 12,477                              | 12,718      |
| <b>NONINTEREST EXPENSE</b>                           |                                     |             |
| Compensation                                         | 15,911                              | 15,859      |
| Occupancy, net                                       | 4,551                               | 4,381       |
| Other Real Estate Owned, net                         | 626                                 | 583         |
| Other                                                | 6,818                               | 7,099       |
| Total Noninterest Expense                            | 27,906                              | 27,922      |
| <b>INCOME BEFORE INCOME TAXES</b>                    | 5,589                               | 4,222       |
| Income Tax (Benefit) Expense                         | (184)                               | 1,478       |
| <b>NET INCOME</b>                                    | \$ 5,773                            | \$ 2,744    |
| <b>BASIC NET INCOME PER SHARE</b>                    | \$ 0.34                             | \$ 0.16     |
| <b>DILUTED NET INCOME PER SHARE</b>                  | \$ 0.34                             | \$ 0.16     |
| Average Basic Shares Outstanding                     | 17,028                              | 16,919      |

|                                    |        |        |
|------------------------------------|--------|--------|
| Average Diluted Shares Outstanding | 17,073 | 16,944 |
|------------------------------------|--------|--------|

*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>                                                                           | <b>Three Months Ended</b> |             |
|---------------------------------------------------------------------------------------------------------|---------------------------|-------------|
|                                                                                                         | <b>March 31,</b>          |             |
|                                                                                                         | <b>2018</b>               | <b>2017</b> |
| <b>NET INCOME</b>                                                                                       | \$ 5,773                  | \$ 2,744    |
| <b>Other comprehensive income (loss), before tax:</b>                                                   |                           |             |
| Change in net unrealized gain/loss on securities available for sale                                     | (1,488)                   | 505         |
| Amortization of unrealized losses on securities transferred from available for sale to held to maturity | 15                        | 20          |
| Total Investment Securities                                                                             | (1,473)                   | 525         |
| <b>Other comprehensive income (loss), before tax</b>                                                    | (1,473)                   | 525         |
| Deferred tax (benefit) expense related to other comprehensive income                                    | (373)                     | (204)       |
| <b>Other comprehensive income (loss), net of tax</b>                                                    | (1,100)                   | 321         |
| <b>TOTAL COMPREHENSIVE INCOME</b>                                                                       | \$ 4,673                  | \$ 3,065    |

*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<br>Other<br>Comprehensive<br>Loss, Net<br>of<br>Taxes | Total      |
|------------------------------------------------------|-------------|--------|--------------------|------------|-------------------------------------------------------------------|------------|
|                                                      | Outstanding | Stock  | Paid-In<br>Capital | Earnings   |                                                                   |            |
| <i>(Dollars In Thousands, Except Share Data)</i>     |             |        |                    |            |                                                                   |            |
| <b>Balance, January 1, 2017</b>                      | 16,844,698  | \$ 168 | \$ 34,188          | \$ 267,037 | \$ (26,225)                                                       | \$ 275,168 |
| Net Income                                           | -           | -      | -                  | 2,744      | -                                                                 | 2,744      |
| Other Comprehensive Income, net of tax               | -           | -      | -                  | -          | 321                                                               | 321        |
| Cash Dividends (\$0.0500 per share)                  | -           | -      | -                  | (847)      | -                                                                 | (847)      |
| Stock Based Compensation                             | -           | -      | 408                | -          | -                                                                 | 408        |
| Impact of Transactions Under Compensation Plans, net | 109,351     | 2      | 263                | -          | -                                                                 | 265        |
| <b>Balance, March 31, 2017</b>                       | 16,954,049  | \$ 170 | \$ 34,859          | \$ 268,934 | \$ (25,904)                                                       | \$ 278,059 |
| <b>Balance, January 1, 2018</b>                      | 16,988,951  | \$ 170 | \$ 36,674          | \$ 279,410 | \$ (32,044)                                                       | \$ 284,210 |
| Net Income                                           | -           | -      | -                  | 5,773      | -                                                                 | 5,773      |
| Other Comprehensive Income, net of tax               | -           | -      | -                  | -          | (1,100)                                                           | (1,100)    |
| Cash Dividends (\$0.0700 per share)                  | -           | -      | -                  | (1,193)    | -                                                                 | (1,193)    |
| Stock Based Compensation                             | -           | -      | 331                | -          | -                                                                 | 331        |
| Impact of Transactions Under Compensation Plans, net | 55,115      | 1      | 338                | -          | -                                                                 | 339        |
| <b>Balance, March 31, 2018</b>                       | 17,044,066  | \$ 171 | \$ 37,343          | \$ 283,990 | \$ (33,144)                                                       | \$ 288,360 |

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

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

| <i>(Dollars in Thousands)</i>                                                    | <b>Three Months Ended March 31,</b> |               |
|----------------------------------------------------------------------------------|-------------------------------------|---------------|
|                                                                                  | <b>2018</b>                         | <b>2017</b>   |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                      |                                     |               |
| Net Income                                                                       | \$ 5,773                            | \$ 2,744      |
| Adjustments to Reconcile Net Income to<br>Cash Provided by Operating Activities: |                                     |               |
| Provision for Loan Losses                                                        | 745                                 | 310           |
| Depreciation                                                                     | 1,605                               | 1,735         |
| Amortization of Premiums, Discounts, and Fees, net                               | 1,723                               | 1,575         |
| Net (Increase) Decrease in Loans Held-for-Sale                                   | (28)                                | 3,388         |
| Stock Compensation                                                               | 331                                 | 408           |
| Net Tax Benefit From Stock-Based Compensation                                    | (41)                                | -             |
| Deferred Income Taxes                                                            | 1,407                               | 1,174         |
| Net Loss on Sales and Write-Downs of Other Real Estate Owned                     | 554                                 | 490           |
| Net (Increase) Decrease in Other Assets                                          | (6,173)                             | 7,926         |
| Net (Decrease) Increase in Other Liabilities                                     | (3,706)                             | 4,168         |
| Net Cash Provided By Operating Activities                                        | 2,190                               | 23,918        |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                      |                                     |               |
| Securities Held to Maturity:                                                     |                                     |               |
| Purchases                                                                        | (35,953)                            | (10,738)      |
| Payments, Maturities, and Calls                                                  | 26,696                              | 29,338        |
| Securities Available for Sale:                                                   |                                     |               |
| Purchases                                                                        | (49,749)                            | (50,022)      |
| Payments, Maturities, and Calls                                                  | 55,221                              | 30,732        |
| Purchases of Loans Held for Investment                                           | (3,965)                             | (18,513)      |
| Net Increase in Loans                                                            | (5,514)                             | (6,099)       |
| Proceeds From Sales of Other Real Estate Owned                                   | 364                                 | 2,114         |
| Purchases of Premises and Equipment                                              | (847)                               | (923)         |
| Net Cash Used In Investing Activities                                            | (13,747)                            | (24,111)      |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                      |                                     |               |
| Net Increase in Deposits                                                         | 29,007                              | 47,019        |
| Net Decrease in Short-Term Borrowings                                            | (2,587)                             | (2,146)       |
| Repayment of Other Long-Term Borrowings                                          | (634)                               | (1,421)       |
| Dividends Paid                                                                   | (1,193)                             | (847)         |
| Issuance of Common Stock Under Compensation Plans                                | 147                                 | 88            |
| Net Cash Provided By Financing Activities                                        | 24,740                              | 42,693        |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>                                 | <b>13,183</b>                       | <b>42,500</b> |
| Cash and Cash Equivalents at Beginning of Period                                 | 285,442                             | 296,047       |
| Cash and Cash Equivalents at End of Period                                       | \$ 298,625                          | \$ 338,547    |

**Supplemental Cash Flow Disclosures:**

Edgar Filing: CAPITAL CITY BANK GROUP INC - Form 10-Q

|                   |    |       |    |     |
|-------------------|----|-------|----|-----|
| Interest Paid     | \$ | 1,451 | \$ | 808 |
| Income Taxes Paid | \$ | -     | \$ | 691 |

**Noncash Investing and Financing Activities:**

|                                                           |    |     |    |       |
|-----------------------------------------------------------|----|-----|----|-------|
| Loans and Premises Transferred to Other Real Estate Owned | \$ | 307 | \$ | 1,541 |
|-----------------------------------------------------------|----|-----|----|-------|

*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.

**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 customers as consideration for managing the customer'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 customers.

The Company has applied ASC 606 using the modified retrospective approach effective on January 1, 2018 to all existing contracts with customers 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. At March 31, 2018, 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:

Edgar Filing: CAPITAL CITY BANK GROUP INC - Form 10-Q

| <u>Period Presented</u>              | <u>Compensation</u> | <u>Line Item</u> | <u>Other Expense</u> |
|--------------------------------------|---------------------|------------------|----------------------|
| <i>(Dollars in Thousands)</i>        |                     |                  |                      |
| Three Months Ended March 31, 2018    | (\$455)             |                  | \$455                |
| Three Months Ended December 31, 2017 | (\$637)             |                  | \$637                |
| Three Months Ended March 31, 2017    | (\$637)             |                  | \$637                |

**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:

|                                                          | March 31, 2018 |                  |                   |              | December 31, 2017 |                 |                   |              |
|----------------------------------------------------------|----------------|------------------|-------------------|--------------|-------------------|-----------------|-------------------|--------------|
|                                                          | Amortized Cost | Unrealized Gains | Unrealized Losses | Market Value | Amortized Cost    | Unrealized Gain | Unrealized Losses | Market Value |
| <b>Available for Sale</b>                                |                |                  |                   |              |                   |                 |                   |              |
| U.S. Government Treasury                                 | \$240,933      | \$ 5             | \$ 3,361          | \$237,577    | \$237,505         | \$ -            | \$ 2,164          | \$235,341    |
| U.S. Government Agency States and Political Subdivisions | 149,074        | 667              | 670               | 149,071      | 144,324           | 727             | 407               | 144,644      |
| Mortgage-Backed Securities                               | 76,486         | -                | 343               | 76,143       | 91,533            | 2               | 378               | 91,157       |
| Equity Securities <sup>(1)</sup>                         | 1,082          | 77               | -                 | 1,159        | 1,102             | 83              | -                 | 1,185        |
| Total                                                    | 7,886          | -                | -                 | 7,886        | 8,584             | -               | -                 | 8,584        |
|                                                          | \$475,461      | \$ 749           | \$ 4,374          | \$471,836    | \$483,048         | \$ 812          | \$ 2,949          | \$480,911    |
| <b>Held to Maturity</b>                                  |                |                  |                   |              |                   |                 |                   |              |
| U.S. Government Treasury                                 | \$ 78,184      | \$ -             | \$ 664            | \$ 77,520    | \$ 98,256         | \$ -            | \$ 441            | \$ 97,815    |
| States and Political Subdivisions                        | 6,940          | -                | 42                | 6,898        | 6,996             | -               | 41                | 6,955        |
| Mortgage-Backed Securities                               | 140,428        | 39               | 2,675             | 137,792      | 111,427           | 22              | 1,212             | 110,237      |
| Total                                                    | \$225,552      | \$ 39            | \$ 3,381          | \$222,210    | \$216,679         | \$ 22           | \$ 1,694          | \$215,007    |
| Total Investment Securities                              | \$701,013      | \$ 788           | \$ 7,755          | \$694,046    | \$699,727         | \$ 834          | \$ 4,643          | \$695,918    |

<sup>(1)</sup> Includes Federal Home Loan Bank and Federal Reserve Bank stock, recorded at cost of \$3.1 million, \$4.8 million, respectively, at March 31, 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 \$328.3 million and \$328.1 million at March 31, 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 March 31, 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>    | <b>Available for Sale</b> |                     | <b>Held to Maturity</b> |                     |
|----------------------------------|---------------------------|---------------------|-------------------------|---------------------|
|                                  | <b>Amortized Cost</b>     | <b>Market Value</b> | <b>Amortized Cost</b>   | <b>Market Value</b> |
| Due in one year or less          | \$ 85,838                 | \$ 85,522           | \$ 43,838               | \$ 43,763           |
| Due after one through five years | 265,050                   | 261,329             | 41,286                  | 40,655              |
| Mortgage-Backed Securities       | 1,082                     | 1,159               | 140,428                 | 137,792             |
| U.S. Government Agency           | 115,605                   | 115,940             | -                       | -                   |
| Equity Securities                | 7,886                     | 7,886               | -                       | -                   |
| Total                            | \$ 475,461                | \$ 471,836          | \$ 225,552              | \$ 222,210          |

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

| <i>(Dollars in Thousands)</i>     | <b>Less Than<br/>12 Months</b> |                              | <b>Greater Than<br/>12 Months</b> |                              | <b>Total</b>            |                              |
|-----------------------------------|--------------------------------|------------------------------|-----------------------------------|------------------------------|-------------------------|------------------------------|
|                                   | <b>Market<br/>Value</b>        | <b>Unrealized<br/>Losses</b> | <b>Market<br/>Value</b>           | <b>Unrealized<br/>Losses</b> | <b>Market<br/>Value</b> | <b>Unrealized<br/>Losses</b> |
| <b>March 31, 2018</b>             |                                |                              |                                   |                              |                         |                              |
| <b>Available for Sale</b>         |                                |                              |                                   |                              |                         |                              |
| U.S. Government Treasury          | \$ 139,880                     | \$ 1,820                     | \$ 87,734                         | \$ 1,541                     | \$227,614               | \$ 3,361                     |
| U.S. Government Agency            | 55,536                         | 376                          | 28,120                            | 294                          | 83,656                  | 670                          |
| States and Political Subdivisions | 68,011                         | 289                          | 5,532                             | 54                           | 73,543                  | 343                          |
| Mortgage-Backed Securities        | 2                              | -                            | -                                 | -                            | 2                       | -                            |
| Total                             | 263,429                        | 2,485                        | 121,386                           | 1,889                        | 384,815                 | 4,374                        |
| <b>Held to Maturity</b>           |                                |                              |                                   |                              |                         |                              |
| U.S. Government Treasury          | 47,622                         | 454                          | 29,898                            | 210                          | 77,520                  | 664                          |
| States and Political Subdivisions | 6,633                          | 42                           | -                                 | -                            | 6,633                   | 42                           |
| Mortgage-Backed Securities        | 94,379                         | 1,560                        | 28,226                            | 1,115                        | 122,605                 | 2,675                        |
| Total                             | \$ 148,634                     | \$ 2,056                     | \$ 58,124                         | \$ 1,325                     | \$206,758               | \$ 3,381                     |
| <b>December 31, 2017</b>          |                                |                              |                                   |                              |                         |                              |
| <b>Available for Sale</b>         |                                |                              |                                   |                              |                         |                              |
| 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                             | 284,181                        | 1,433                        | 111,206                           | 1,516                        | 395,387                 | 2,949                        |
| <b>Held to Maturity</b>           |                                |                              |                                   |                              |                         |                              |
| 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                             | \$ 140,846                     | \$ 808                       | \$ 45,155                         | \$ 886                       | \$186,001               | \$ 1,694                     |

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 March 31, 2018, there were 538 positions (combined AFS and HTM) with unrealized losses totaling \$7.8 million. 63 of these positions were U.S. government treasury securities guaranteed by the U.S. government. 236 of these positions were U.S. government agency and mortgage-backed securities issued by U.S. government sponsored entities, with the remaining 239 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 March 31, 2018.

**NOTE 3 – LOANS, NET**

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

| <i>(Dollars in Thousands)</i>            | <b>March 31, 2018</b> | <b>December 31, 2017</b> |
|------------------------------------------|-----------------------|--------------------------|
| Commercial, Financial and Agricultural   | \$ 198,775            | \$ 218,166               |
| Real Estate – Construction               | 80,236                | 77,966                   |
| Real Estate – Commercial Mortgage        | 551,309               | 535,707                  |
| Real Estate – Residential <sup>(1)</sup> | 322,038               | 311,906                  |
| Real Estate – Home Equity                | 223,994               | 229,513                  |
| Consumer <sup>(2)</sup>                  | 285,543               | 280,234                  |
| Loans, Net of Unearned Income            | \$ 1,661,895          | \$ 1,653,492             |

<sup>(1)</sup> *Includes loans in process with outstanding balances of \$15.9 million and \$9.1 million at March 31, 2018 and December 31, 2017, respectively.*

<sup>(2)</sup> *Includes overdraft balances of \$1.2 million and \$1.6 million at March 31, 2018 and December 31, 2017, respectively.*

Net deferred costs included in loans were \$1.4 million at March 31, 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 of Atlanta and has pledged a blanket floating lien on all consumer loans, commercial loans, and construction loans to support available borrowing capacity at the Federal Reserve Bank of Atlanta.

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

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

Edgar Filing: CAPITAL CITY BANK GROUP INC - Form 10-Q

| <i>(Dollars in Thousands)</i>             | <b>March 31, 2018</b> |                  | <b>December 31, 2017</b> |                  |
|-------------------------------------------|-----------------------|------------------|--------------------------|------------------|
|                                           | <b>Nonaccrual</b>     | <b>90 + Days</b> | <b>Nonaccrual</b>        | <b>90 + Days</b> |
| Commercial, Financial and Agricultural \$ | 567                   | \$ -             | \$ 629                   | \$ -             |
| Real Estate – Construction                | 608                   | -                | 297                      | -                |
| Real Estate – Commercial Mortgage         | 1,940                 | -                | 2,370                    | -                |
| Real Estate – Residential                 | 2,398                 | -                | 1,938                    | -                |
| Real Estate – Home Equity                 | 1,686                 | -                | 1,748                    | -                |
| Consumer                                  | 115                   | -                | 177                      | 36               |
| Total Nonaccrual Loans                    | \$ 7,314              | \$ -             | \$ 7,159                 | \$ 36            |



*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>          | <b>30-59<br/>DPD</b> | <b>60-89<br/>DPD</b> | <b>90 +<br/>DPD</b> | <b>Total<br/>Past Due</b> | <b>Total<br/>Current</b> | <b>Total<br/>Loans<sup>(1)</sup></b> |
|----------------------------------------|----------------------|----------------------|---------------------|---------------------------|--------------------------|--------------------------------------|
| <b>March 31, 2018</b>                  |                      |                      |                     |                           |                          |                                      |
| Commercial, Financial and Agricultural | \$ 125               | \$ 149               | \$ -                | \$ 274                    | \$ 197,934               | \$ 198,775                           |
| Real Estate – Construction             | 162                  | -                    | -                   | 162                       | 79,466                   | 80,236                               |
| Real Estate – Commercial Mortgage      | 360                  | 917                  | -                   | 1,277                     | 548,092                  | 551,309                              |
| Real Estate – Residential              | 1,252                | 33                   | -                   | 1,285                     | 318,355                  | 322,038                              |
| Real Estate – Home Equity              | 234                  | 1                    | -                   | 235                       | 222,073                  | 223,994                              |
| Consumer                               | 690                  | 345                  | -                   | 1,035                     | 284,393                  | 285,543                              |
| Total Past Due Loans                   | \$ 2,823             | \$ 1,445             | \$ -                | \$ 4,268                  | \$ 1,650,313             | \$ 1,661,895                         |
| <b>December 31, 2017</b>               |                      |                      |                     |                           |                          |                                      |
| 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                         |

<sup>(1)</sup> 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> | <b>Commercial,<br/>Financial,<br/>Agricultural</b> | <b>Real<br/>Estate<br/>Construction</b> | <b>Real<br/>Estate<br/>Commercial<br/>Mortgage</b> | <b>Real<br/>Estate<br/>Residential</b> | <b>Real<br/>Estate<br/>Home<br/>Equity</b> | <b>Consumer</b> | <b>Total</b> |
|-------------------------------|----------------------------------------------------|-----------------------------------------|----------------------------------------------------|----------------------------------------|--------------------------------------------|-----------------|--------------|
|                               |                                                    |                                         |                                                    |                                        |                                            |                 |              |

**Three Months Ended****March 31, 2018**

|                           |          |        |          |          |          |          |           |
|---------------------------|----------|--------|----------|----------|----------|----------|-----------|
| Beginning Balance         | \$ 1,191 | \$ 122 | \$ 4,346 | \$ 3,206 | \$ 2,506 | \$ 1,936 | \$ 13,307 |
| Provision for Loan Losses | (44)     | 128    | (126)    | 180      | (90)     | 697      | 745       |
| Charge-Offs               | (182)    | (7)    | (290)    | (107)    | (158)    | (695)    | (1,439)   |
| Recoveries                | 166      | 1      | 123      | 84       | 61       | 210      | 645       |
| Net Charge-Offs           | (16)     | (6)    | (167)    | (23)     | (97)     | (485)    | (794)     |
| Ending Balance            | \$ 1,131 | \$ 244 | \$ 4,053 | \$ 3,363 | \$ 2,319 | \$ 2,148 | \$ 13,258 |

**Three Months Ended****March 31, 2017**

|                           |          |        |          |          |          |          |           |
|---------------------------|----------|--------|----------|----------|----------|----------|-----------|
| Beginning Balance         | \$ 1,198 | \$ 168 | \$ 4,315 | \$ 3,445 | \$ 2,297 | \$ 2,008 | \$ 13,431 |
| Provision for Loan Losses | (36)     | (68)   | (187)    | (166)    | 288      | 479      | 310       |
| Charge-Offs               | (93)     | -      | (71)     | (116)    | (92)     | (624)    | (996)     |
| Recoveries                | 81       | -      | 23       | 213      | 29       | 244      | 590       |
| Net Charge-Offs           | (12)     | -      | (48)     | 97       | (63)     | (380)    | (406)     |
| Ending Balance            | \$ 1,150 | \$ 100 | \$ 4,080 | \$ 3,376 | \$ 2,522 | \$ 2,107 | \$ 13,335 |

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.

|                               | <b>Commercial,<br/>Financial,<br/>Agricultural</b> | <b>Real<br/>Estate<br/>Construction</b> | <b>Real Estate<br/>Commercial<br/>Mortgage</b> | <b>Real<br/>Estate<br/>Residential</b> | <b>Real Estate<br/>Home Equity</b> | <b>Consumer</b> | <b>Total</b> |
|-------------------------------|----------------------------------------------------|-----------------------------------------|------------------------------------------------|----------------------------------------|------------------------------------|-----------------|--------------|
| <i>(Dollars in Thousands)</i> |                                                    |                                         |                                                |                                        |                                    |                 |              |
| <b>March 31, 2018</b>         |                                                    |                                         |                                                |                                        |                                    |                 |              |
| Period-end amount             |                                                    |                                         |                                                |                                        |                                    |                 |              |
| Allocated to:                 |                                                    |                                         |                                                |                                        |                                    |                 |              |
| Loans Individually            |                                                    |                                         |                                                |                                        |                                    |                 |              |
| Evaluated for Impairment      | \$ 182                                             | \$ 114                                  | \$ 1,779                                       | \$ 1,412                               | \$ 389                             | \$ 1            | \$ 3,877     |
| Loans Collectively            |                                                    |                                         |                                                |                                        |                                    |                 |              |
| Evaluated for Impairment      | 949                                                | 130                                     | 2,274                                          | 1,951                                  | 1,930                              | 2,147           | 9,381        |
| Ending Balance                | \$ 1,131                                           | \$ 244                                  | \$ 4,053                                       | \$ 3,363                               | \$ 2,319                           | \$ 2,148        | \$ 13,258    |
| <b>December 31, 2017</b>      |                                                    |                                         |                                                |                                        |                                    |                 |              |
| 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                | \$ 1,191                                           | \$ 122                                  | \$ 4,346                                       | \$ 3,206                               | \$ 2,506                           | \$ 1,936        | \$ 13,307    |
| <b>March 31, 2017</b>         |                                                    |                                         |                                                |                                        |                                    |                 |              |
| Period-end amount             |                                                    |                                         |                                                |                                        |                                    |                 |              |
| Allocated to:                 |                                                    |                                         |                                                |                                        |                                    |                 |              |
| Loans Individually            |                                                    |                                         |                                                |                                        |                                    |                 |              |
| Evaluated for Impairment      | \$ 94                                              | \$ 2                                    | \$ 2,027                                       | \$ 1,486                               | \$ 445                             | \$ 4            | \$ 4,058     |
| Loans Collectively            |                                                    |                                         |                                                |                                        |                                    |                 |              |
| Evaluated for Impairment      | 1,056                                              | 98                                      | 2,053                                          | 1,890                                  | 2,077                              | 2,103           | 9,277        |
| Ending Balance                | \$ 1,150                                           | \$ 100                                  | \$ 4,080                                       | \$ 3,376                               | \$ 2,522                           | \$ 2,107        | \$ 13,335    |

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<br/>Thousands)</i>           | <b>Commercial,<br/>Financial,</b> | <b>Real Estate</b>  | <b>Real Estate<br/>Commercial</b> | <b>Real Estate</b> | <b>Real Estate</b> | <b>Consumer</b>   | <b>Total</b>        |
|---------------------------------------------|-----------------------------------|---------------------|-----------------------------------|--------------------|--------------------|-------------------|---------------------|
|                                             | <b>Agricultural</b>               | <b>Construction</b> | <b>Mortgage</b>                   | <b>Residential</b> | <b>Home Equity</b> |                   |                     |
| <b>March 31,<br/>2018</b>                   |                                   |                     |                                   |                    |                    |                   |                     |
| Individually<br>Evaluated for<br>Impairment | \$ 1,283                          | \$ 671              | \$ 18,445                         | \$ 13,204          | \$ 3,198           | \$ 109            | \$ 36,910           |
| Collectively<br>Evaluated for<br>Impairment | 197,492                           | 79,565              | 532,864                           | 308,834            | 220,796            | 285,434           | 1,624,985           |
| <b>Total</b>                                | <b>\$ 198,775</b>                 | <b>\$ 80,236</b>    | <b>\$ 551,309</b>                 | <b>\$ 322,038</b>  | <b>\$ 223,994</b>  | <b>\$ 285,543</b> | <b>\$ 1,661,895</b> |
| <b>December 31,<br/>2017</b>                |                                   |                     |                                   |                    |                    |                   |                     |
| Individually<br>Evaluated for<br>Impairment | \$ 1,378                          | \$ 361              | \$ 19,280                         | \$ 12,871          | \$ 3,332           | \$ 113            | \$ 37,335           |
| Collectively<br>Evaluated for<br>Impairment | 216,788                           | 77,605              | 516,427                           | 299,035            | 226,181            | 280,121           | 1,616,157           |
| <b>Total</b>                                | <b>\$ 218,166</b>                 | <b>\$ 77,966</b>    | <b>\$ 535,707</b>                 | <b>\$ 311,906</b>  | <b>\$ 229,513</b>  | <b>\$ 280,234</b> | <b>\$ 1,653,492</b> |
| <b>March 31,<br/>2017</b>                   |                                   |                     |                                   |                    |                    |                   |                     |
| Individually<br>Evaluated for<br>Impairment | \$ 1,238                          | \$ 362              | \$ 23,061                         | \$ 14,699          | \$ 3,514           | \$ 145            | \$ 43,019           |
| Collectively<br>Evaluated for<br>Impairment | 213,357                           | 59,576              | 480,807                           | 290,293            | 227,786            | 270,121           | 1,541,940           |
| <b>Total</b>                                | <b>\$ 214,595</b>                 | <b>\$ 59,938</b>    | <b>\$ 503,868</b>                 | <b>\$ 304,992</b>  | <b>\$ 231,300</b>  | <b>\$ 270,266</b> | <b>\$ 1,584,959</b> |

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

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

| <i>(Dollars in Thousands)</i>          | <b>Unpaid<br/>Principal<br/>Balance</b> | <b>Recorded<br/>Investment<br/>With No Allowance</b> | <b>Recorded<br/>Investment<br/>With<br/>Allowance</b> | <b>Related<br/>Allowance</b> |
|----------------------------------------|-----------------------------------------|------------------------------------------------------|-------------------------------------------------------|------------------------------|
| <b>March 31, 2018</b>                  |                                         |                                                      |                                                       |                              |
| Commercial, Financial and Agricultural | \$ 1,283                                | \$ 114                                               | \$ 1,169                                              | \$ 182                       |
| Real Estate – Construction             | 671                                     | -                                                    | 671                                                   | 114                          |
| Real Estate – Commercial Mortgage      | 18,445                                  | 1,389                                                | 17,056                                                | 1,779                        |
| Real Estate – Residential              | 13,204                                  | 1,773                                                | 11,431                                                | 1,412                        |
| Real Estate – Home Equity              | 3,198                                   | 1,419                                                | 1,779                                                 | 389                          |
| Consumer                               | 109                                     | 42                                                   | 67                                                    | 1                            |
| Total                                  | \$ 36,910                               | \$ 4,737                                             | \$ 32,173                                             | \$ 3,877                     |
| <b>December 31, 2017</b>               |                                         |                                                      |                                                       |                              |
| 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.

|                                        | <b>Three Months Ended March 31,</b>        |                                      |                                            |                                      |
|----------------------------------------|--------------------------------------------|--------------------------------------|--------------------------------------------|--------------------------------------|
|                                        | <b>2018</b>                                |                                      | <b>2017</b>                                |                                      |
| <i>(Dollars in Thousands)</i>          | <b>Average<br/>Recorded<br/>Investment</b> | <b>Total<br/>Interest<br/>Income</b> | <b>Average<br/>Recorded<br/>Investment</b> | <b>Total<br/>Interest<br/>Income</b> |
| Commercial, Financial and Agricultural | \$ 1,330                                   | \$ 29                                | \$ 1,140                                   | \$ 12                                |
| Real Estate – Construction             | 517                                        | 1                                    | 305                                        | -                                    |
| Real Estate – Commercial Mortgage      | 18,862                                     | 175                                  | 23,458                                     | 223                                  |
| Real Estate – Residential              | 13,038                                     | 148                                  | 15,147                                     | 180                                  |
| Real Estate – Home Equity              | 3,265                                      | 26                                   | 3,445                                      | 27                                   |
| Consumer                               | 111                                        | 2                                    | 159                                        | 2                                    |
| <b>Total</b>                           | <b>\$ 37,123</b>                           | <b>\$ 381</b>                        | <b>\$ 43,654</b>                           | <b>\$ 444</b>                        |

*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> | <b>Commercial,<br/>Financial,<br/>Agriculture</b> | <b>Real Estate</b> | <b>Consumer</b> | <b>Total Criticized<br/>Loans</b> |
|-------------------------------|---------------------------------------------------|--------------------|-----------------|-----------------------------------|
| <b>March 31, 2018</b>         |                                                   |                    |                 |                                   |
| Special Mention               | \$ 3,937                                          | \$ 12,779          | \$ 62           | \$ 16,778                         |
| Substandard                   | 1,050                                             | 30,173             | 486             | 31,709                            |
| Doubtful                      | -                                                 | -                  | -               | -                                 |
| Total Criticized Loans        | \$ 4,987                                          | \$ 42,952          | \$ 548          | \$ 48,487                         |
| <b>December 31, 2017</b>      |                                                   |                    |                 |                                   |
| Special Mention               | \$ 7,879                                          | \$ 13,324          | \$ 65           | \$ 21,268                         |
| Substandard                   | 1,057                                             | 29,291             | 654             | 31,002                            |
| Doubtful                      | -                                                 | -                  | -               | -                                 |
| Total Criticized Loans        | \$ 8,936                                          | \$ 42,615          | \$ 719          | \$ 52,270                         |

*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>          | <b>March 31, 2018</b> |                    | <b>December 31, 2017</b> |                    |
|----------------------------------------|-----------------------|--------------------|--------------------------|--------------------|
|                                        | <b>Accruing</b>       | <b>Nonaccruing</b> | <b>Accruing</b>          | <b>Nonaccruing</b> |
| Commercial, Financial and Agricultural | \$ 802                | \$ 230             | \$ 822                   | \$ -               |
| Real Estate – Construction             | 63                    | -                  | 64                       | -                  |
| Real Estate – Commercial Mortgage      | 16,712                | 1,351              | 17,058                   | 1,636              |
| Real Estate – Residential              | 11,451                | 548                | 11,666                   | 503                |
| Real Estate – Home Equity              | 2,336                 | 102                | 2,441                    | 186                |
| Consumer                               | 108                   | -                  | 113                      | -                  |
| Total TDRs                             | \$ 31,472             | \$ 2,231           | \$ 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>          | <b>Three Months Ended March 31, 2018</b> |                                         |                                          | <b>Three Months Ended March 31, 2017</b> |                                         |                                          |
|----------------------------------------|------------------------------------------|-----------------------------------------|------------------------------------------|------------------------------------------|-----------------------------------------|------------------------------------------|
|                                        | <b>Number of Contracts</b>               | <b>Pre-Modified Investment Recorded</b> | <b>Post-Modified Investment Recorded</b> | <b>Number of Contracts</b>               | <b>Pre-Modified Investment Recorded</b> | <b>Post-Modified Investment Recorded</b> |
| Commercial, Financial and Agricultural | 1                                        | \$ 497                                  | \$ 230                                   | -                                        | \$ -                                    | \$ -                                     |
| Real Estate – Construction             | -                                        | -                                       | -                                        | 1                                        | 64                                      | 65                                       |
| Real Estate – Commercial Mortgage      | 1                                        | 228                                     | 228                                      | -                                        | -                                       | -                                        |
| Real Estate – Home Equity              | -                                        | -                                       | -                                        | 1                                        | 56                                      | 55                                       |
| Consumer                               | -                                        | -                                       | -                                        | -                                        | -                                       | -                                        |
| Total TDRs                             | 2                                        | \$ 725                                  | \$ 458                                   | 2                                        | \$ 120                                  | \$ 120                                   |

For the three months ended March 31, 2018 and March 31, 2017, there were no loans modified as TDRs within the previous 12 months that have substantially defaulted.

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

| <i>(Dollars in Thousands)</i> | <b>Three Months Ended March 31, 2018</b> |                                          | <b>Three Months Ended March 31, 2017</b> |                                          |
|-------------------------------|------------------------------------------|------------------------------------------|------------------------------------------|------------------------------------------|
|                               | <b>Number of Contracts</b>               | <b>Recorded Investment<sup>(1)</sup></b> | <b>Number of Contracts</b>               | <b>Recorded Investment<sup>(1)</sup></b> |

Edgar Filing: CAPITAL CITY BANK GROUP INC - Form 10-Q

|                                                    |   |        |   |        |
|----------------------------------------------------|---|--------|---|--------|
| Extended amortization                              | 1 | \$ 228 | - | \$ -   |
| Interest rate adjustment                           | - | -      | 2 | 120    |
| Extended amortization and interest rate adjustment | - | -      | - | -      |
| Principal Moratorium                               | 1 | 230    | - | -      |
| Other                                              | - | -      | - | -      |
| Total TDRs                                         | 2 | \$ 458 | 2 | \$ 120 |

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

**NOTE 4 – OTHER REAL ESTATE OWNED**

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

| <i>(Dollars in Thousands)</i> | <b>Three Months Ended March 31,</b> |             |
|-------------------------------|-------------------------------------|-------------|
|                               | <b>2018</b>                         | <b>2017</b> |
| Beginning Balance             | \$ 3,941                            | \$ 10,638   |
| Additions                     | 307                                 | 1,541       |
| Valuation Write-downs         | (494)                               | (494)       |
| Sales                         | (424)                               | (2,111)     |
| Other                         | -                                   | (73)        |
| Ending Balance                | \$ 3,330                            | \$ 9,501    |

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

| <i>(Dollars in Thousands)</i>      | <b>Three Months Ended March 31,</b> |             |
|------------------------------------|-------------------------------------|-------------|
|                                    | <b>2018</b>                         | <b>2017</b> |
| Gains from the Sale of Properties  | \$ (28)                             | \$ (106)    |
| Losses from the Sale of Properties | 88                                  | 102         |
| Rental Income from Properties      | (3)                                 | (32)        |
| Property Carrying Costs            | 75                                  | 125         |
| Valuation Adjustments              | 494                                 | 494         |
| Total                              | \$ 626                              | \$ 583      |

As of March 31, 2018, the Company had \$1.8 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:

**Three Months Ended March 31,**

| <i>(Dollars in Thousands)</i>       | <b>2018</b> | <b>2017</b> |
|-------------------------------------|-------------|-------------|
| Service Cost                        | \$ 1,721    | \$ 1,688    |
| Interest Cost                       | 1,415       | 1,437       |
| Expected Return on Plan Assets      | (2,391)     | (2,006)     |
| Prior Service Cost Amortization     | 50          | 56          |
| Net Loss Amortization               | 918         | 953         |
| Net Periodic Benefit Cost           | \$ 1,713    | \$ 2,128    |
| Discount Rate Used for Benefit Cost | 3.71%       | 4.21%       |
| Long-term Rate of Return on Assets  | 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>       | <b>Three Months Ended March 31,</b> |             |
|-------------------------------------|-------------------------------------|-------------|
|                                     | <b>2018</b>                         | <b>2017</b> |
| Interest Cost                       | \$ 57                               | \$ 48       |
| Net Loss Amortization               | 406                                 | 149         |
| Net Periodic Benefit Cost           | \$ 463                              | \$ 197      |
| Discount Rate Used for Benefit Cost | 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 quarter of 2018, the Company made a \$10 million contribution 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>               | <b>March 31, 2018</b> |                 |              | <b>December 31, 2017</b> |                 |              |
|---------------------------------------------|-----------------------|-----------------|--------------|--------------------------|-----------------|--------------|
|                                             | <b>Fixed</b>          | <b>Variable</b> | <b>Total</b> | <b>Fixed</b>             | <b>Variable</b> | <b>Total</b> |
| Commitments to Extend Credit <sup>(1)</sup> | \$ 85,979             | \$ 387,437      | \$ 473,416   | \$ 78,390                | \$ 366,750      | \$ 445,140   |
| Standby Letters of Credit                   | 4,727                 | -               | 4,727        | 4,678                    | -               | 4,678        |
| Total                                       | \$ 90,706             | \$ 387,437      | \$ 478,143   | \$ 83,068                | \$ 366,750      | \$ 449,818   |

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

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

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a client to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities. In general, management does not anticipate any material losses as a result of participating in

these types of transactions. However, any potential losses arising from such transactions are reserved for in the same manner as management reserves for its other credit facilities.

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

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

*Indemnification Obligation.* The Company is a member of the Visa U.S.A. network. Visa U.S.A member banks are required to indemnify it for potential future settlement of certain litigation (the "Covered Litigation") that relates to several antitrust lawsuits challenging the practices of Visa and MasterCard International. In 2008, the Company, as a member of the Visa U.S.A. network, obtained Class B shares of Visa, Inc. upon its initial public offering. Since its initial public offering, Visa, Inc. has funded a litigation reserve for the Covered Litigation resulting in a reduction in the Class B shares held by the Company. During the first quarter of 2011, the Company sold its remaining Class B shares resulting in a \$3.2 million pre-tax gain. Associated with this sale, the Company entered into a swap contract with the purchaser of the shares that requires a payment to the counterparty in the event that Visa, Inc. makes subsequent revisions to the conversion ratio for its Class B shares. Fixed charges included in the swap liability are payable quarterly until the litigation reserve is fully liquidated and at which time the aforementioned swap contract will be terminated. Quarterly fixed payments approximate \$115,000. 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. From time to time, the Company will validate, on a sample basis, prices supplied by



the independent pricing service by comparison to prices obtained from third-party sources or derived using internal models.

*Fair Value Swap.* The Company entered into a stand-alone derivative contract with the purchaser of its Visa Class B shares. The valuation represents the amount due and payable to the counterparty based upon the revised share conversion rate, if any, during the period. At March 31, 2018, there were no amounts payable.

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

| <i>(Dollars in Thousands)</i>                               | <b>Level 1<br/>Inputs</b> | <b>Level 2<br/>Inputs</b> | <b>Level 3<br/>Inputs</b> | <b>Total Fair<br/>Value</b> |
|-------------------------------------------------------------|---------------------------|---------------------------|---------------------------|-----------------------------|
| <b>March 31, 2018</b>                                       |                           |                           |                           |                             |
| Securities Available for Sale:                              |                           |                           |                           |                             |
| U.S. Government Treasury                                    | \$ 237,577                | \$ -                      | \$ -                      | \$ 237,577                  |
| U.S. Government Agency<br>States and Political Subdivisions | -                         | 149,071<br>76,143         | -                         | 149,071<br>76,143           |
| Mortgage-Backed Securities                                  | -                         | 1,159                     | -                         | 1,159                       |
| Equity Securities                                           | -                         | 7,886                     | -                         | 7,886                       |
| <b>December 31, 2017</b>                                    |                           |                           |                           |                             |
| Securities Available for Sale:                              |                           |                           |                           |                             |
| U.S. Government Treasury                                    | \$ 235,341                | \$ -                      | \$ -                      | \$ 235,341                  |
| U.S. Government Agency<br>States and Political Subdivisions | -                         | 144,644<br>91,157         | -                         | 144,644<br>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 \$6.0 million with a valuation allowance of \$1.0 million at March 31, 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 three 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>             | <b>Carrying<br/>Value</b> | <b>March 31, 2018</b>     |                           |                           |
|-------------------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
|                                           |                           | <b>Level 1<br/>Inputs</b> | <b>Level 2<br/>Inputs</b> | <b>Level 3<br/>Inputs</b> |
| <b>ASSETS:</b>                            |                           |                           |                           |                           |
| Cash                                      | \$ 47,804                 | \$ 47,804                 | \$ -                      | \$ -                      |
| Short-Term Investments                    | 250,821                   | 250,821                   | -                         | -                         |
| Investment Securities, Available for Sale | 471,836                   | 237,577                   | 234,259                   | -                         |
| Investment Securities, Held to Maturity   | 225,552                   | 77,520                    | 144,690                   | -                         |
| Equity Securities <sup>(1)</sup>          | 3,600                     | -                         | 3,600                     | -                         |
| Loans Held for Sale                       | 4,845                     | -                         | 4,845                     | -                         |
| Loans, Net of Allowance for Loan Losses   | 1,648,637                 | -                         | -                         | 1,617,733                 |
| <b>LIABILITIES:</b>                       |                           |                           |                           |                           |
| Deposits                                  | \$ 2,498,884              | \$ -                      | \$ 2,497,022              | \$ -                      |
| Short-Term Borrowings                     | 4,893                     | -                         | 4,893                     | -                         |
| Subordinated Notes Payable                | 52,887                    | -                         | 43,912                    | -                         |
| Long-Term Borrowings                      | 13,333                    | -                         | 13,363                    | -                         |

| <i>(Dollars in Thousands)</i>             | <b>Carrying<br/>Value</b> | <b>December 31, 2017</b>  |                           |                           |
|-------------------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
|                                           |                           | <b>Level 1<br/>Inputs</b> | <b>Level 2<br/>Inputs</b> | <b>Level 3<br/>Inputs</b> |
| <b>ASSETS:</b>                            |                           |                           |                           |                           |
| 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                 |
| <b>LIABILITIES:</b>                       |                           |                           |                           |                           |
| 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                    | -                         |

<sup>(1)</sup> 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>                                                                | <b>Before<br/>Tax<br/>Amount</b> | <b>Tax<br/>(Expense)<br/>Benefit</b> | <b>Net of<br/>Tax<br/>Amount</b> |
|----------------------------------------------------------------------------------------------|----------------------------------|--------------------------------------|----------------------------------|
| <b>March 31, 2018</b>                                                                        |                                  |                                      |                                  |
| Investment Securities:                                                                       |                                  |                                      |                                  |
| Change in net unrealized gain/loss on securities available for sale                          | \$ (1,488)                       | \$ 377                               | \$ (1,111)                       |
| Amortization of losses on securities transferred from available for sale to held to maturity | 15                               | (4)                                  | 11                               |
| Total Other Comprehensive Loss                                                               | \$ (1,473)                       | \$ 373                               | \$ (1,100)                       |
| <b>March 31, 2017</b>                                                                        |                                  |                                      |                                  |
| Investment Securities:                                                                       |                                  |                                      |                                  |
| Change in net unrealized gain/loss on securities available for sale                          | \$ 505                           | \$ (196)                             | \$ 309                           |
| Amortization of losses on securities transferred from available for sale to held to maturity | 20                               | (8)                                  | 12                               |
| Total Other Comprehensive Income                                                             | \$ 525                           | \$ (204)                             | \$ 321                           |

Accumulated other comprehensive loss was comprised of the following components:

| <i>(Dollars in Thousands)</i>                | <b>Securities<br/>Available<br/>for Sale</b> | <b>Retirement<br/>Plans</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> |
|----------------------------------------------|----------------------------------------------|-----------------------------|---------------------------------------------------------|
| <b>Balance as of January 1, 2018</b>         | \$ (1,743)                                   | \$ (30,301)                 | \$ (32,044)                                             |
| Other comprehensive income during the period | (1,100)                                      | -                           | (1,100)                                                 |
| <b>Balance as of March 31, 2018</b>          | \$ (2,843)                                   | \$ (30,301)                 | \$ (33,144)                                             |
| <b>Balance as of January 1, 2017</b>         | \$ (583)                                     | \$ (25,642)                 | \$ (26,225)                                             |
| Other comprehensive income during the period | 321                                          | -                           | 321                                                     |
| <b>Balance as of March 31, 2017</b>          | \$ (262)                                     | \$ (25,642)                 | \$ (25,904)                                             |

**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, developed a project plan, and selected a vendor to provide a solution to assist in model development. 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 is effective for the Company on July 1, 2018 and is not expected to have a significant impact on its financial statements.



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

Management's discussion and analysis ("MD&A") provides supplemental information, which sets forth the major factors that have affected our financial condition and results of operations and should be read in conjunction with the Consolidated Financial Statements and related notes. The following information should provide a better understanding of the major factors and trends that affect our earnings performance and financial condition, and how our performance during 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 that removes the effect of goodwill resulting from merger and acquisition activity. We believe this measure is 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        |             |             |             |
|------------------------------------------------|---------------|-------------|-------------|-------------|-------------|-------------|
|                                                | First         | Fourth      | Third       | Second      | First       | Fourth      |
| Shareowners' Equity (GAAP)                     | \$ 288,360    | \$ 284,210  | \$ 285,201  | \$ 281,513  | \$ 278,059  | \$ 275,160  |
| Less: Goodwill (GAAP)                          | 84,811        | 84,811      | 84,811      | 84,811      | 84,811      | 84,811      |
| Tangible Shareowners' Equity (non-GAAP)        | A 203,549     | 199,399     | 200,390     | 196,702     | 193,248     | 190,349     |
| Total Assets (GAAP)                            | 2,924,832     | 2,898,794   | 2,790,842   | 2,814,843   | 2,895,531   | 2,845,190   |
| Less: Goodwill (GAAP)                          | 84,811        | 84,811      | 84,811      | 84,811      | 84,811      | 84,811      |
| Tangible Assets (non-GAAP)                     | B \$2,840,021 | \$2,813,983 | \$2,706,031 | \$2,730,032 | \$2,810,720 | \$2,760,379 |
| <b>Tangible Common Equity Ratio (non-GAAP)</b> | A/B 7.17%     | 7.09%       | 7.41%       | 7.21%       | 6.88%       | 6.90%       |

**SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

| <i>(Dollars in Thousands, Except<br/>Per Share Data)</i> | <b>2018</b> |             | <b>2017</b> |             |             |             |
|----------------------------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
|                                                          | First       | Fourth      | Third       | Second      | First       | Fourth      |
| <b>Summary of Operations:</b>                            |             |             |             |             |             |             |
| Interest Income                                          | \$ 23,214   | \$ 22,627   | \$ 22,341   | \$ 21,422   | \$ 20,540   | \$ 20,832   |
| Interest Expense                                         | 1,451       | 1,138       | 1,080       | 926         | 804         | 773         |
| Net Interest Income                                      | 21,763      | 21,489      | 21,261      | 20,496      | 19,736      | 20,059      |
| Provision for Loan Losses                                | 745         | 826         | 490         | 589         | 310         | 464         |
| Net Interest Income After<br>Provision for Loan Losses   | 21,018      | 20,663      | 20,771      | 19,907      | 19,426      | 19,595      |
| Noninterest Income <sup>(2)</sup>                        | 12,477      | 12,897      | 12,996      | 13,135      | 12,718      | 12,778      |
| Noninterest Expense                                      | 27,906      | 26,897      | 26,707      | 27,921      | 27,922      | 27,560      |
| Income Before Income Taxes                               | 5,589       | 6,663       | 7,060       | 5,121       | 4,222       | 4,813       |
| Income Tax (Benefit) Expense <sup>(3)</sup>              | (184)       | 6,660       | 2,505       | 1,560       | 1,478       | 1,517       |
| Net Income                                               | 5,773       | 3           | 4,555       | 3,561       | 2,744       | 3,296       |
| Net Interest Income (FTE)                                | \$ 21,943   | \$ 21,808   | \$ 21,595   | \$ 20,799   | \$ 20,006   | \$ 20,335   |
| <b>Per Common Share:</b>                                 |             |             |             |             |             |             |
| Net Income Basic                                         | \$ 0.34     | \$ 0.00     | \$ 0.27     | \$ 0.21     | \$ 0.16     | \$ 0.20     |
| Net Income Diluted                                       | 0.34        | 0.00        | 0.27        | 0.21        | 0.16        | 0.20        |
| Cash Dividends Declared                                  | 0.07        | 0.07        | 0.07        | 0.05        | 0.05        | 0.05        |
| Diluted Book Value                                       | 16.87       | 16.65       | 16.73       | 16.54       | 16.38       | 16.23       |
| Market Price:                                            |             |             |             |             |             |             |
| High                                                     | 26.50       | 26.01       | 24.58       | 22.39       | 21.79       | 23.15       |
| Low                                                      | 22.80       | 22.21       | 19.60       | 17.68       | 19.22       | 14.29       |
| Close                                                    | 24.75       | 22.94       | 24.01       | 20.42       | 21.39       | 20.48       |
| <b>Selected Average Balances:</b>                        |             |             |             |             |             |             |
| Loans, Net                                               | \$1,647,612 | \$1,640,738 | \$1,638,578 | \$1,608,629 | \$1,585,561 | \$1,573,264 |
| Earning Assets                                           | 2,592,465   | 2,511,985   | 2,466,287   | 2,502,030   | 2,529,207   | 2,423,388   |
| Total Assets                                             | 2,892,120   | 2,822,451   | 2,779,960   | 2,817,479   | 2,845,140   | 2,743,463   |
| Deposits                                                 | 2,456,106   | 2,378,411   | 2,329,162   | 2,373,423   | 2,407,278   | 2,306,917   |
| Shareowners' Equity                                      | 287,502     | 288,044     | 285,296     | 281,661     | 278,489     | 278,943     |
| Common Equivalent Average<br>Shares:                     |             |             |             |             |             |             |
| Basic                                                    | 17,028      | 16,967      | 16,965      | 16,955      | 16,919      | 16,809      |
| Diluted                                                  | 17,073      | 17,050      | 17,044      | 17,016      | 16,944      | 16,913      |
| <b>Performance Ratios:</b>                               |             |             |             |             |             |             |
| Return on Average Assets                                 | 0.81%       | 0.00%       | 0.65%       | 0.51%       | 0.39%       | 0.48%       |
| Return on Average Equity                                 | 8.14        | 0.00        | 6.33        | 5.07        | 4.00        | 4.70        |
| Net Interest Margin (FTE)                                | 3.43        | 3.45        | 3.48        | 3.33        | 3.21        | 3.34        |
| Noninterest Income as % of                               |             |             |             |             |             |             |
| Operating Revenue                                        | 36.44       | 37.51       | 37.94       | 39.05       | 39.19       | 38.91       |
| Efficiency Ratio                                         | 81.07       | 77.50       | 77.21       | 82.28       | 85.33       | 83.23       |
| <b>Asset Quality:</b>                                    |             |             |             |             |             |             |

Edgar Filing: CAPITAL CITY BANK GROUP INC - Form 10-Q

|                                    |    |        |    |        |    |        |    |        |    |        |    |        |    |
|------------------------------------|----|--------|----|--------|----|--------|----|--------|----|--------|----|--------|----|
| Allowance for Loan Losses          | \$ | 13,258 | \$ | 13,307 | \$ | 13,339 | \$ | 13,242 | \$ | 13,335 | \$ | 13,431 | \$ |
| Allowance for Loan Losses to Loans |    | 0.80%  |    | 0.80%  |    | 0.82%  |    | 0.81%  |    | 0.84%  |    | 0.86%  |    |
| Nonperforming Assets (“NPAs”)      |    | 10,644 |    | 11,100 |    | 12,545 |    | 15,934 |    | 17,799 |    | 19,171 |    |
| NPAs to Total Assets               |    | 0.36   |    | 0.38   |    | 0.45   |    | 0.57   |    | 0.61   |    | 0.67   |    |
| NPAs to Loans plus OREO            |    | 0.64   |    | 0.67   |    | 0.76   |    | 0.97   |    | 1.11   |    | 1.21   |    |
| Allowance to Non-Performing Loans  |    | 181.26 |    | 185.87 |    | 203.39 |    | 166.23 |    | 160.70 |    | 157.40 |    |
| Net Charge-Offs to Average Loans   |    | 0.20   |    | 0.21   |    | 0.10   |    | 0.17   |    | 0.10   |    | 0.20   |    |

**Capital Ratios:**

|                                       |  |        |  |        |  |        |  |        |  |        |  |        |  |
|---------------------------------------|--|--------|--|--------|--|--------|--|--------|--|--------|--|--------|--|
| Tier 1 Capital                        |  | 16.31% |  | 16.33% |  | 16.19% |  | 15.58% |  | 15.68% |  | 15.51% |  |
| Total Capital                         |  | 17.05  |  | 17.10  |  | 16.96  |  | 16.32  |  | 16.44  |  | 16.28  |  |
| Common Equity Tier 1                  |  | 13.44  |  | 13.42  |  | 13.26  |  | 12.72  |  | 12.77  |  | 12.61  |  |
| Leverage                              |  | 10.36  |  | 10.47  |  | 10.48  |  | 10.20  |  | 9.95   |  | 10.23  |  |
| Tangible Common Equity <sup>(1)</sup> |  | 7.17   |  | 7.09   |  | 7.41   |  | 7.21   |  | 6.88   |  | 6.90   |  |

<sup>(1)</sup>Non-GAAP financial measure. See non-GAAP reconciliation on page 27.

<sup>(2)</sup>Includes \$2.5 million gain on partial retirement of trust preferred securities in second quarter, 2016.

<sup>(3)</sup>Includes \$1.5 income tax benefit in the first quarter, 2018 related to a 2017 plan year pension plan contribution and \$4.1 million 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 \$5.8 million, or \$0.34 per diluted share, for the first quarter of 2018 compared to net income of \$0.0 million, or \$0.00 per diluted share, for the fourth quarter of 2017, and net income of \$2.7 million, or \$0.16 per diluted share for the first quarter of 2017. Net income for the first quarter of 2018 included a \$1.5 million, or \$0.09 per diluted share tax benefit related to a 2017 plan year pension plan contribution. Net income for the fourth quarter of 2017 included a \$4.1 million, or \$0.24 per diluted share, income tax expense related to the re-measurement of our net deferred tax assets due to tax reform.

- Tax equivalent net interest income for the first quarter of 2018 was \$21.9 million compared to \$21.8 million for the fourth quarter of 2017 and \$20.0 million for the first quarter of 2017. During the first quarter of 2018, overnight funds increased as a result of seasonal growth in our public fund deposits, and to a lesser degree, savings accounts. A portion of these overnight funds were used to fund growth in the loan and investment portfolios. The increase in tax equivalent net interest income compared to the first quarter of 2017 reflected growth in the loan portfolio and higher rates earned on overnight funds, investment securities, and variable rate loans, partially offset by a higher cost on our negotiated rate deposits.

- Provision for loan losses was \$0.7 million for the first quarter of 2018 compared to \$0.8 million for the fourth quarter of 2017 and \$0.3 million for the first quarter of 2017. The higher provision compared to the first quarter of 2017 reflected higher loan charge-offs and growth in the loan portfolio.

- Noninterest income for the first quarter of 2018 totaled \$12.5 million, a decrease of \$0.5 million, or 3.3%, from the fourth quarter of 2017 and \$0.2 million, or 1.9%, from the first quarter of 2017. The decrease from both prior periods was primarily attributable to lower mortgage banking fees and generally reflected a seasonal slowdown in loan funding, and to a lesser extent a lower margin on sold loans.

- Noninterest expense for the first quarter of 2018 totaled \$27.9 million, an increase of \$1.0 million, or 3.8%, over the fourth quarter of 2017 and comparable to the first quarter of 2017. The increase over the fourth quarter of 2017 was primarily attributable to a seasonal increase in compensation expense (re-set of payroll taxes and incentives) and other real estate owned (“OREO”) expense.

## Financial Condition

- Average earning assets were \$2.592 billion for the first quarter of 2018, an increase of \$80.5 million, or 3.2%, from the fourth quarter of 2017, and an increase of \$63.3 million, or 2.5%, over the first quarter of 2017. The change in average earning assets over both prior periods reflected a higher level of total deposits.
- Average loans increased by \$6.9 million, or 0.4%, over the fourth quarter of 2017, and \$62.1 million, or 3.9%, over the first quarter of 2017. The increase compared to the fourth quarter of 2017 primarily reflected growth in commercial mortgage, construction, and consumer loans, partially offset by a reduction in the remaining loan types. Growth over the first quarter of 2017 was experienced in all loan products, with the exception of commercial and home equity loans.
- Nonperforming assets totaled \$10.6 million at March 31, 2018, a decrease of \$0.5 million, or 4.3%, from December 31, 2017 and \$7.2 million, or 40.2%, from March 31, 2017. Nonperforming assets represented 0.36% of total assets at March 31, 2018 compared to 0.38% at December 31, 2017 and 0.61% at March 31, 2017.
- At March 31, 2018, we were well-capitalized with a risk based capital ratio of 17.05% and a tangible common equity ratio of 7.17% compared to 17.10% and 7.09%, respectively, at December 31, 2017, and 16.44% and 6.88%, respectively, at March 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 first quarter of 2018, we realized net income of \$5.8 million, or \$0.34 per diluted share, compared to net income of \$3,000, or \$0.00 per diluted share for the fourth quarter of 2017, and \$2.7 million, or \$0.16 per diluted share for the first quarter of 2017.

Net income for the first quarter of 2018 included a \$1.5 million, or \$0.09 per diluted share tax benefit related to a 2017 plan year pension plan contribution. Net income for the fourth quarter of 2017 included a \$4.1 million, or \$0.24 per diluted share, income tax expense related to the re-measurement of our net deferred tax assets due to tax reform.



Compared to the fourth quarter of 2017, the \$1.1 million decrease in operating profit reflected a \$1.0 million increase in noninterest expense and lower noninterest income of \$0.5 million, partially offset by higher net interest income of \$0.3 million and a \$0.1 million reduction in the loan loss provision.

Compared to the first quarter of 2017, the \$1.4 million increase in operating profit was attributable to higher net interest income of \$2.0 million, partially offset by lower noninterest income of \$0.2 million and a \$0.4 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> | <b>Three Months Ended</b> |                              |                       |
|------------------------------------------------------|---------------------------|------------------------------|-----------------------|
|                                                      | <b>March 31, 2018</b>     | <b>December 31,<br/>2017</b> | <b>March 31, 2017</b> |
| Interest Income                                      | \$ 23,214                 | \$ 22,627                    | \$ 20,540             |
| Taxable Equivalent Adjustments                       | 180                       | 319                          | 270                   |
| Total Interest Income (FTE)                          | 23,394                    | 22,946                       | 20,810                |
| Interest Expense                                     | 1,451                     | 1,138                        | 804                   |
| Net Interest Income (FTE)                            | 21,943                    | 21,808                       | 20,006                |
| Provision for Loan Losses                            | 745                       | 826                          | 310                   |
| Taxable Equivalent Adjustments                       | 180                       | 319                          | 270                   |
| Net Interest Income After provision for Loan Losses  | 21,018                    | 20,663                       | 19,426                |
| Noninterest Income                                   | 12,477                    | 12,897                       | 12,718                |
| Noninterest Expense                                  | 27,906                    | 26,897                       | 27,922                |
| Income Before Income Taxes                           | 5,589                     | 6,663                        | 4,222                 |
| Income Tax (Benefit) Expense                         | (184)                     | 6,660                        | 1,478                 |
| Net Income                                           | \$ 5,773                  | \$ 3                         | \$ 2,744              |
| Basic Net Income Per Share                           | \$ 0.34                   | \$ -                         | \$ 0.16               |
| Diluted Net Income Per Share                         | \$ 0.34                   | \$ -                         | \$ 0.16               |

### **Net Interest Income**

Net interest income represents our single largest source of earnings and is equal to interest income and fees generated by earning assets less interest expense paid on interest-bearing liabilities. This information is provided on a "taxable equivalent" basis to reflect the tax-exempt status of income earned on certain loans and investments. We provide an analysis of our net interest income including average yields and rates in Table I on page 41.



During the first quarter of 2018, overnight funds increased as a result of seasonal growth in our public fund deposits, and to a lesser degree, savings accounts. A portion of these overnight funds were used to fund growth in the loan and investment portfolios.

Tax-equivalent net interest income for the first quarter of 2018 was \$21.9 million compared to \$21.8 million for the fourth quarter of 2017 and \$20.0 million for the first quarter of 2017. The increase in tax-equivalent net interest income compared to the first quarter of 2017 reflected growth in the loan portfolio and higher rates earned on overnight funds, investment securities, and variable rate loans, partially offset by a higher cost on our negotiated rate deposits.

The federal funds target rate increased six times since December 2015 to 1.75% at the end of the first 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 deposits, we continue to prudently manage our overall cost of funds, which was 23 basis points for the first quarter of 2018, compared to 18 basis points for fourth quarter of 2017 and 13 basis points for the first quarter 2017. Despite highly competitive fixed-rate loan pricing across most markets, we continue to review our loan pricing and make adjustments where appropriate.

Our net interest margin for the first quarter of 2018 was 3.43%, a decrease of two basis points from the fourth quarter of 2017 and an increase of 22 basis points over the first quarter of 2017. Relative to both comparative periods, the average yield for each earning asset category improved. The decrease in the margin compared to the fourth quarter of 2017 was due to seasonal growth in our overnight funds, resulting in a slightly less favorable asset mix. The increase in the margin compared to the first quarter of 2017 was primarily attributable to loan growth and higher earning asset yields, partially offset by higher rates on our negotiated rate deposits.

**Provision for Loan Losses**

The provision for loan losses for the first quarter of 2018 was \$0.7 million compared to \$0.8 million for the fourth quarter of 2017 and \$0.3 million for the first quarter of 2017. The higher provision compared to the first quarter of 2017 reflected higher loan charge-offs and growth in the loan portfolio. Net loan charge-offs for the first quarter of 2018 totaled \$0.8 million, or 0.20% (annualized), of average loans compared to \$0.9 million, or 0.21% (annualized), for the fourth quarter of 2017 and \$0.4 million, or 0.10% (annualized), for the first quarter of 2017. At March 31, 2018, the allowance for loan losses of \$13.3 million was 0.80% of outstanding loans (net of overdrafts) and provided coverage of 181% of nonperforming loans compared to 0.80% and 186%, respectively, at December 31, 2017 and 0.84% and 161%, respectively, at March 31, 2017.

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

| <i>(Dollars in Thousands, except per share data)</i>                                                 | <b>Three Months Ended</b> |                              |                       |
|------------------------------------------------------------------------------------------------------|---------------------------|------------------------------|-----------------------|
|                                                                                                      | <b>March 31, 2018</b>     | <b>December 31,<br/>2017</b> | <b>March 31, 2017</b> |
| <b>CHARGE-OFFS</b>                                                                                   |                           |                              |                       |
| Commercial, Financial and Agricultural                                                               | \$ 182                    | \$ 664                       | \$ 93                 |
| Real Estate - Construction                                                                           | 7                         | -                            | -                     |
| Real Estate - Commercial Mortgage                                                                    | 290                       | 42                           | 71                    |
| Real Estate - Residential                                                                            | 107                       | 126                          | 116                   |
| Real Estate - Home Equity                                                                            | 158                       | 48                           | 92                    |
| Consumer                                                                                             | 695                       | 577                          | 624                   |
| Total Charge-offs                                                                                    | \$ 1,439                  | \$ 1,457                     | \$ 996                |
| <b>RECOVERIES</b>                                                                                    |                           |                              |                       |
| Commercial, Financial and Agricultural                                                               | \$ 166                    | \$ 113                       | \$ 81                 |
| Real Estate - Construction                                                                           | 1                         | -                            | -                     |
| Real Estate - Commercial Mortgage                                                                    | 123                       | 24                           | 23                    |
| Real Estate - Residential                                                                            | 84                        | 141                          | 213                   |
| Real Estate - Home Equity                                                                            | 61                        | 67                           | 29                    |
| Consumer                                                                                             | 210                       | 254                          | 244                   |
| Total Recoveries                                                                                     | \$ 645                    | \$ 599                       | \$ 590                |
| Net Charge-offs                                                                                      | \$ 794                    | \$ 858                       | \$ 406                |
| Net Charge-offs (Annualized) as a percent of<br>Average Loans<br>Outstanding, Net of Unearned Income | 0.20%                     | 0.21%                        | 0.10%                 |

**Noninterest Income**

Noninterest income for the first quarter of 2018 totaled \$12.5 million, a decrease of \$0.5 million, or 3.3%, from the fourth quarter of 2017 and \$0.2 million, or 1.9%, from the first quarter of 2017. The decrease from the fourth quarter of 2017 was primarily attributable to lower mortgage banking fees of \$0.4 million and deposit fees of \$0.2 million. The decrease from the first quarter of 2017 was primarily attributable to lower mortgage banking fees of \$0.3 million and deposit fees of \$0.2 million, partially offset by higher wealth management fees \$0.3 million.

The table below reflects the major components of noninterest income.

| <i>(Dollars in Thousands)</i>   | <b>March 31, 2018</b> | <b>Three Months Ended<br/>December 31,<br/>2017</b> | <b>March 31, 2017</b> |
|---------------------------------|-----------------------|-----------------------------------------------------|-----------------------|
| Deposit Fees                    | \$ 4,872              | \$ 5,040                                            | \$ 5,090              |
| Bank Card Fees                  | 2,811                 | 2,830                                               | 2,803                 |
| Wealth Management Fees          | 2,173                 | 2,172                                               | 1,842                 |
| Mortgage Banking Fees           | 1,057                 | 1,410                                               | 1,308                 |
| Other                           | 1,564                 | 1,445                                               | 1,675                 |
| <b>Total Noninterest Income</b> | <b>\$ 12,477</b>      | <b>\$ 12,897</b>                                    | <b>\$ 12,718</b>      |

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

*Deposit Fees.* Deposit fees for the first quarter of 2018 totaled \$4.9 million, a decrease of \$0.2 million, or 3.3%, from the fourth quarter of 2017 and a decrease of \$0.2 million, or 4.3%, from the first quarter of 2017. The decrease from both prior year periods reflected lower overdraft service fees due to a reduction in accounts using this service as well as lower utilization by existing users. Over the past year, we have realized improvement in checking account maintenance fees which has partially offset the decline in overdraft fees. Review and evaluation of our checking account product features as well as opportunities to migrate legacy accounts to our new checking account lineup is an ongoing process and we expect this project to gain momentum as we move through the remainder of 2018.

*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 first quarter of 2018, comparable to the fourth quarter of 2017 and an increase of \$0.3 million, or 18.0%, over the first quarter of 2017. During the first quarter of 2018, we migrated to a new retail brokerage processing platform and recognized a \$0.3 million vendor bonus as part of this transition. The bonus in part served to compensate us for a slowdown in revenues due to the transition as well as offset transition related expenses. In addition to the bonus, the improvement in wealth management fees over the first quarter of 2017 reflected higher trust fees attributable to an increase in assets under management. At March 31, 2018, total assets under management were approximately \$1.407 billion compared to \$1.418 billion at December 31, 2017 and \$1.289 billion at March 31, 2017.

*Mortgage Banking Fees.* Mortgage banking fees totaled \$1.1 million for the first quarter of 2018, a decrease of \$0.4 million, or 25.0%, from the fourth quarter of 2017 and \$0.2 million, or 19.2%, from the first quarter of 2017. The decrease from both prior year periods reflected a seasonal slowdown in loan funding and to a lesser extent a lower margin on sold loans.

## **Noninterest Expense**

Noninterest expense for the first quarter of 2018 totaled \$27.9 million, an increase of \$1.0 million, or 3.8%, over the fourth quarter of 2017 and comparable to the first quarter of 2017. The increase from the fourth quarter was attributable to higher compensation expense of \$0.8 million, other expense of \$0.1 million, and occupancy expense of \$0.1 million. The increase in compensation expense was seasonal and primarily reflected the reset of both payroll taxes and incentives. Expense management is an important part of our culture and strategic focus and we continue to review and evaluate opportunities to optimize our operations, reduce operating costs and manage our discretionary expenses.

The table below reflects the major components of noninterest expense.

| <i>(Dollars in Thousands)</i>    | <b>March 31, 2018</b> | <b>Three Months Ended<br/>December 31,<br/>2017</b> | <b>March 31, 2017</b> |
|----------------------------------|-----------------------|-----------------------------------------------------|-----------------------|
| Salaries                         | \$ 11,873             | \$ 11,303                                           | \$ 11,764             |
| Associate Benefits               | 4,038                 | 3,800                                               | 4,095                 |
| Total Compensation               | 15,911                | 15,103                                              | 15,859                |
| <br>                             |                       |                                                     |                       |
| Premises                         | 2,209                 | 2,164                                               | 2,204                 |
| Equipment                        | 2,342                 | 2,236                                               | 2,177                 |
| Total Occupancy                  | 4,551                 | 4,400                                               | 4,381                 |
| <br>                             |                       |                                                     |                       |
| Legal Fees                       | 476                   | 505                                                 | 485                   |
| Professional Fees                | 1,146                 | 1,084                                               | 904                   |
| Processing Services              | 1,532                 | 1,341                                               | 1,645                 |
| Advertising                      | 287                   | 438                                                 | 467                   |
| Travel and Entertainment         | 180                   | 278                                                 | 174                   |
| Printing and Supplies            | 163                   | 152                                                 | 176                   |
| Telephone                        | 594                   | 547                                                 | 829                   |
| Postage                          | 206                   | 178                                                 | 216                   |
| Insurance - Other                | 401                   | 404                                                 | 402                   |
| Other Real Estate Owned, net     | 626                   | 355                                                 | 583                   |
| Miscellaneous                    | 1,833                 | 2,112                                               | 1,801                 |
| Total Other                      | 7,444                 | 7,394                                               | 7,682                 |
| <br>                             |                       |                                                     |                       |
| <b>Total Noninterest Expense</b> | <b>\$ 27,906</b>      | <b>\$ 26,897</b>                                    | <b>\$ 27,922</b>      |

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

*Compensation.* Compensation expense totaled \$15.9 million for the first quarter of 2018, an increase of \$0.8 million, or 5.3%, over the fourth quarter of 2017 and a decrease of \$0.1 million, or 0.3%, from the first quarter of 2017. The increase over the fourth quarter of 2017 was seasonal and reflected the normal first quarter reset of both payroll taxes and incentives. In the first quarter of 2018, we reclassified certain non-service cost components of our pension expense in accordance with ASU 2017-07. Prior year amounts were retrospectively adjusted in accordance with the accounting standard. See Note 1 – Significant Accounting Policies for additional information.

*Occupancy.* Occupancy expense (including premises and equipment) totaled \$4.6 million for the first quarter of 2018, an increase of \$0.1 million, or 3.4%, over the fourth quarter of 2017 and \$0.2 million, or 3.9%, over the first quarter of 2017. The increase over both prior year periods was attributable to higher equipment maintenance costs.

*Other.* Other noninterest expense increased \$0.1 million, or 0.7%, over the fourth quarter of 2017 and decreased \$0.3 million, or 3.1%, from the first quarter of 2017. The increase compared to the fourth quarter of 2017 was primarily attributable to higher OREO expense of \$0.3 million and processing expense of \$0.2 million, partially offset by a decline in miscellaneous expense of \$0.2 million and advertising expense of \$0.1 million. OREO expense increased due to a valuation adjustment for one parcel of property. The increase in processing expense reflected our annual debit card processing volume rebate that was received in the fourth quarter of 2017. The decrease in miscellaneous expense reflected the aforementioned reclassification of certain components of our pension expense. . The decrease in advertising expense was generally due to a lower level of both brand and product promotions during the first quarter of 2018. The decline in expense compared to the first quarter of 2017 was primarily driven by lower telephone expense of \$0.2 million, advertising expense of \$0.2 million, and processing services of \$0.1 million, partially offset by an increase in professional fees of \$0.2 million. The decline in telephone expense was due to running dual circuits during the first quarter of 2017 as we implemented a new telephone system. Advertising expense declined due to a lower level of product promotions. Professional expenses increased due to a review of our checking account products and features, as well as other consulting engagements.

Our operating efficiency ratio (expressed as noninterest expense as a percent of the sum of taxable-equivalent net interest income plus noninterest income) was 81.07% for the first quarter of 2018 compared to 77.50% for the fourth quarter of 2017 and 85.33% for the first quarter of 2017. The increase compared to the fourth quarter of 2017 reflected the increase in operating expenses, while the decline compared to the first quarter of 2017 was attributable to year over year revenue growth.

## **Income Taxes**

We realized an income tax benefit of \$0.2 million for the first quarter of 2018, which included a discrete tax benefit of \$1.5 million resulting from the effect of federal tax reform, enacted in December 2017, on a pension plan contribution made in the first quarter of 2018 for the 2017 pension plan year. Absent this discrete item, our effective tax rate was approximately 24%. Income tax expense for the fourth quarter of 2017 was \$6.7 million and included a \$4.1 million discrete tax expense related to the re-measurement of our net deferred tax asset, also due to the federal tax reform enacted in December. Income tax expense for the first quarter of 2017 was \$1.5 million and reflected a federal tax rate of 35%.

## **FINANCIAL CONDITION**

Average earning assets were \$2.592 billion for the first quarter of 2018, an increase of \$80.5 million, or 3.2%, over the fourth quarter of 2017, and an increase of \$63.3 million, or 2.5%, over the first quarter of 2017. The change in earning assets over the prior quarter reflected growth in our loan and investment portfolios, in addition to higher levels of overnight funds, primarily due to an increase in public funds deposits. The increase compared to the first quarter 2017 reflected growth in the loan and investment portfolios, funded primarily by increases in noninterest bearing and savings accounts.

## **Investment Securities**

In the first quarter of 2018, our average investment portfolio increased \$7.3 million, or 1.0%, over the fourth quarter of 2017 and increased \$5.4 million, or 0.8%, over the first quarter of 2017. Securities in our investment portfolio represented 27.2% of our average earning assets in the first quarter of 2018, compared to 27.7% in the fourth quarter of 2017, and 27.6% in the first quarter of 2017. For the remainder of 2018, we will continue to closely monitor liquidity levels, as well as look for new investment products that are prudent relative to our risk profile and overall investment strategy. Liquidity levels, including anticipated cash flow from the investment portfolio, will determine the extent to which investment cash flow will 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 first quarter of 2018, we purchased securities under both the AFS and HTM designations. At March 31, 2018, \$471.8 million, or 67.7%, of our investment portfolio was classified as AFS, and \$225.6 million, or 32.3%, classified as HTM.



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 March 31, 2018, there were 538 positions (combined AFS and HTM) with unrealized losses totaling \$7.8 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.

| <i>(Dollars in Thousands)</i>     | <b>12 months or</b>        |                   |                          |               |                   |                          |              |                   |                          |
|-----------------------------------|----------------------------|-------------------|--------------------------|---------------|-------------------|--------------------------|--------------|-------------------|--------------------------|
|                                   | <b>Less Than 12 months</b> |                   |                          | <b>Longer</b> |                   |                          | <b>Total</b> |                   |                          |
|                                   | <b>Count</b>               | <b>Value</b>      | <b>Unrealized Losses</b> | <b>Count</b>  | <b>Value</b>      | <b>Unrealized Losses</b> | <b>Count</b> | <b>Value</b>      | <b>Unrealized Losses</b> |
| GNMA                              | 110                        | \$ 94,381         | \$ 1,560                 | 46            | \$ 28,226         | \$ 1,115                 | 156          | \$ 122,607        | \$ 2,675                 |
| UST                               | 38                         | 187,502           | 2,274                    | 25            | 117,632           | 1,751                    | 63           | 305,134           | 4,025                    |
| SBA                               | 57                         | 49,285            | 328                      | 2             | 1,239             | 4                        | 59           | 50,524            | 332                      |
| FHLB and FFCB                     | 4                          | 6,251             | 48                       | 17            | 26,881            | 290                      | 21           | 33,132            | 338                      |
| States and Political Subdivisions | 224                        | 74,644            | 331                      | 15            | 5,532             | 54                       | 239          | 80,176            | 385                      |
| <b>Total</b>                      | <b>433</b>                 | <b>\$ 412,063</b> | <b>\$ 4,541</b>          | <b>105</b>    | <b>\$ 179,510</b> | <b>\$ 3,214</b>          | <b>538</b>   | <b>\$ 591,573</b> | <b>\$ 7,755</b>          |

## Loans

Average loans increased \$6.9 million, or 0.4% when compared to the fourth quarter of 2017, and have grown \$62.1 million, or 3.9% when compared to the first quarter of 2017. The average increase compared to the fourth quarter of 2017 primarily reflected growth in commercial mortgage, construction, and consumer loans, partially offset by a reduction in the remaining loan types. Average growth over the first quarter of 2017 was experienced in all loan categories, with the exception of commercial and home equity loans. A portion of this growth compared to the first quarter 2017 was attributable to three separate loan pool purchases totaling \$28.9 million at the time of purchase. The loans were individually reviewed and evaluated in accordance with our credit underwriting standards.

We continue to make minor modifications on some of our lending programs to mitigate the impact that consumer and business deleveraging has had on our portfolio. These programs, coupled with economic improvements in our anchor markets and strategic loan purchases, have helped increase overall loan growth.

## Nonperforming Assets

Nonperforming assets (nonaccrual loans and OREO) totaled \$10.6 million at March 31, 2018, a decrease of \$0.5 million, or 4.3%, from December 31, 2017 and \$7.2 million, or 40.2%, from March 31, 2017. Nonaccrual loans totaled \$7.3 million at March 31, 2018, a \$0.2 million increase over December 31, 2017 and a \$1.0 million decrease from March 31, 2017. Nonaccrual loan additions totaled \$3.8 million for the first quarter of 2018 compared to \$5.6 million for the fourth quarter of 2017 and \$2.9 million for the first quarter of 2017. The balance of OREO totaled \$3.3 million at March 31, 2018, a decrease of \$0.6 million and \$6.2 million, respectively, from December 31, 2017 and March 31, 2017. For the first quarter of 2018, we added properties totaling \$0.3 million, sold properties totaling \$0.4 million, and recorded valuation adjustments totaling \$0.5 million. Nonperforming assets represented 0.36% of total assets at March 31, 2018 compared to 0.38% at December 31, 2017 and 0.61% at March 31, 2017.

| <i>(Dollars in Thousands)</i>                      | <b>March 31, 2018</b> | <b>December 31, 2017</b> | <b>March 31, 2017</b> |
|----------------------------------------------------|-----------------------|--------------------------|-----------------------|
| Nonaccruing Loans:                                 |                       |                          |                       |
| Commercial, Financial and Agricultural             | \$ 567                | \$ 629                   | \$ 538                |
| Real Estate - Construction                         | 608                   | 298                      | 363                   |
| Real Estate - Commercial Mortgage                  | 1,940                 | 2,370                    | 3,970                 |
| Real Estate - Residential                          | 2,398                 | 1,938                    | 1,724                 |
| Real Estate - Home Equity                          | 1,686                 | 1,748                    | 1,587                 |
| Consumer                                           | 115                   | 176                      | 116                   |
| Total Nonperforming Loans (“NPLs” <sup>(1)</sup> ) | \$ 7,314              | \$ 7,159                 | \$ 8,298              |
| Other Real Estate Owned                            | 3,330                 | 3,941                    | 9,501                 |
| Total Nonperforming Assets (“NPAs”)                | \$ 10,644             | \$ 11,100                | \$ 17,799             |
| Past Due Loans 30 – 89 Days                        | \$ 4,268              | \$ 4,543                 | \$ 3,263              |

Edgar Filing: CAPITAL CITY BANK GROUP INC - Form 10-Q

|                                           |           |           |           |
|-------------------------------------------|-----------|-----------|-----------|
| Past Due Loans 90 Days or More (accruing) | -         | 36        | -         |
| Performing Troubled Debt Restructurings   | \$ 31,472 | \$ 32,164 | \$ 36,555 |
| Nonperforming Loans/Loans                 | 0.44%     | 0.43%     | 0.52%     |
| Nonperforming Assets/Total Assets         | 0.36      | 0.38      | 0.61      |
| Nonperforming Assets/Loans Plus OREO      | 0.64      | 0.67      | 1.11      |
| Allowance/Nonperforming Loans             | 181.26%   | 185.87%   | 160.70%   |

(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> | <b>Three Months Ended March 31,</b> |             |
|-------------------------------|-------------------------------------|-------------|
|                               | <b>2018</b>                         | <b>2017</b> |
| <b>NPA Beginning Balance:</b> | \$ 11,100                           | \$ 19,171   |
| Change in Nonaccrual Loans:   |                                     |             |
| Beginning Balance             | 7,159                               | 8,533       |
| Additions                     | 3,774                               | 2,868       |
| Charge-Offs                   | (955)                               | (556)       |
| Transferred to OREO           | (307)                               | (638)       |
| Paid Off/Payments             | (574)                               | (693)       |
| Restored to Accrual           | (1,783)                             | (1,216)     |
| Ending Balance                | 7,314                               | 8,298       |
| Change in OREO:               |                                     |             |
| Beginning Balance             | 3,941                               | 10,638      |
| Additions                     | 307                                 | 1,541       |
| Valuation Write-downs         | (494)                               | (494)       |
| Sales                         | (424)                               | (2,111)     |
| Other                         | -                                   | (73)        |
| Ending Balance                | 3,330                               | 9,501       |
| <b>NPA Net Change</b>         | (456)                               | (1,372)     |
| <b>NPA Ending Balance</b>     | \$ 10,644                           | \$ 17,799   |

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

| <i>(Dollars in Thousands)</i>           | <b>Three Months Ended March 31,</b> |             |
|-----------------------------------------|-------------------------------------|-------------|
|                                         | <b>2018</b>                         | <b>2017</b> |
| <b>TDR Beginning Balance:</b>           | \$ 34,489                           | \$ 39,976   |
| Additions                               | 458                                 | 120         |
| Charge-Offs                             | (370)                               | (79)        |
| Paid Off/Payments                       | (874)                               | (910)       |
| Removal Due to Change in TDR Status     | -                                   | -           |
| Transferred to OREO                     | -                                   | (41)        |
| <b>TDR Ending Balance<sup>(1)</sup></b> | \$ 33,703                           | \$ 39,066   |

<sup>(1)</sup> 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 management believes collection of the principal is unlikely. The allowance for loan losses is based on management's judgment of overall loan quality. This is a significant estimate based on a detailed analysis of the loan portfolio. The balance can and will change based on changes in the assessment of the loan portfolio's overall credit quality. We evaluate the adequacy of the allowance for loan losses on a quarterly basis.

The allowance for loan losses was \$13.3 million at March 31, 2018 comparable to December 31, 2017 and March 31, 2017. The allowance for loan losses was 0.80% of outstanding loans (net of overdrafts) and provided coverage of 181% of nonperforming loans at March 31, 2018 compared to 0.80% and 186%, respectively, at December 31, 2017 and 0.84% and 161%, respectively, at March 31, 2017. We believe that the allowance for loan losses was adequate to absorb losses inherent in our loan portfolio at March 31, 2018.

## Deposits

Average total deposits were \$2.456 billion for the first quarter of 2018, an increase of \$77.7 million, or 3.3% over the fourth quarter of 2017, and an increase of \$48.8 million, or 2.0% over the first quarter of 2017. The increase in average deposits compared to the fourth quarter of 2017 reflected increases in negotiated NOW and savings accounts. The seasonal inflows of public funds peaked in the first quarter of 2018 for this cycle and are expected to decline into the fourth quarter of 2018. Average deposits compared to first quarter of 2017 reflected strong growth in noninterest bearing deposits and savings accounts.

Deposit levels remain strong, particularly given the recent increases in the overnight funds rate. Average core deposits continue to experience growth. 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. At this time, all shock scenarios for net interest earnings at risk are within the desired ranges, while the -100bp shock scenario for EVE of -17.5% remains slightly out of our desired target range of -15.0% as exposure to falling rates is more extreme due to the low level of current deposit costs and limited capacity to reduce those costs relative to comparable discount benchmarks used to value them..

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

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

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

| <b>Percentage Change (12-month shock)</b> | <b>+400 bp</b> | <b>+300 bp</b> | <b>+200 bp</b> | <b>+100 bp</b> | <b>-100 bp</b> |
|-------------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Policy Limit                              | -15.0%         | -12.5%         | -10.0%         | -7.5%          | -7.5%          |
| March 31, 2018                            | 13.1%          | 9.7%           | 6.3%           | 3.1%           | -7.5%          |
| December 31, 2017                         | 13.4%          | 9.9%           | 6.4%           | 3.1%           | -8.5%          |
| <b>Percentage Change (24-month shock)</b> | <b>+400 bp</b> | <b>+300 bp</b> | <b>+200 bp</b> | <b>+100 bp</b> | <b>-100 bp</b> |
| Policy Limit                              | -17.5%         | -15.0%         | -12.5%         | -10.0%         | -10.0%         |
| March 31, 2018                            | 40.7%          | 31.4%          | 22.1%          | 13.2%          | -9.6%          |
| December 31, 2017                         | 39.9%          | 30.4%          | 20.9%          | 11.8%          | -12.0%         |

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 100bp will have a negative impact on our net interest margin. The 12-month Net Interest Income at Risk positions were unchanged or declined slightly in a rising rate environment, and became more favorable in the down 100bp scenario at the end of the first quarter of 2018 when compared to the prior quarter-end. The 24-month Net Income at Risk positions improved over the last quarter for all rate shock scenarios.

All measures of net interest income at risk are within our prescribed policy limits, including rate shocks of -100 bp over both a 12-month and 24-month period. These metrics became more favorable and within guidelines as high Beta deposit rates have risen enough off their floors to give us room to reduce them in response to a falling rate environment. To a lesser degree, slightly longer investment purchases also reduced NII exposure in a rates down scenario.

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 <sup>(1)</sup>

| Changes in Interest Rates | +400 bp | +300 bp | +200 bp | +100 bp | -100 bp |
|---------------------------|---------|---------|---------|---------|---------|
| Policy Limit              | -30.0%  | -25.0%  | -20.0%  | -15.0%  | -15.0%  |
| March 31, 2018            | 28.3%   | 22.4%   | 15.7%   | 8.9%    | -17.5%  |
| December 31, 2017         | 31.1%   | 24.7%   | 17.5%   | 9.7%    | -21.0%  |

At March 31, 2018, the economic value of equity in all rising rate scenarios versus the base case was slightly less favorable compared to the prior quarter, but more favorable in the falling rate scenario compared to the prior quarter. The EVE in the rates down 100 bp scenario remains outside of the desired parameters as exposure to falling rates is more extreme due to the low level of current deposit costs and limited capacity to reduce those costs relative to comparable discount benchmarks used to value them. However, EVE in the down 100 bps rate shock scenario became more favorable as high Beta deposit rates have risen enough off their floors to give us room to reduce them in response to a falling rate environment. To a lesser degree, slightly longer investment purchases also reduced exposure in a falling rate scenario.

(1) Down 200, 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 March 31, 2018, we had the ability to generate \$1.282 billion in additional liquidity through all of our available resources (this excludes \$251 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 March 31, 2018, we believe the liquidity available to us was sufficient to meet our needs.

We view our investment portfolio primarily as a source of liquidity and have the option to pledge the portfolio as collateral for borrowings or deposits, and/or sell selected securities. The portfolio consists of debt issued by the U.S. Treasury, U.S. governmental and federal agencies, and municipal governments. The weighted average life of the portfolio was approximately 2.11 years, and at March 31, 2018, it had a net unrealized pre-tax loss of \$3.6 million in the available-for-sale portfolio.

Our average overnight funds position (defined as funds sold plus interest bearing deposits with other banks less funds purchased) was \$240.9 million during the first quarter of 2018 compared to \$174.6 million in the fourth quarter of 2017 and \$245.2 million in the first quarter of 2017. The change in the average net overnight funds compared to both prior periods is related to variances in deposit balances.

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 March 31, 2018, advances from the FHLB totaled \$11.1 million in outstanding debt consisting of 13 notes. During the first three months of 2018, the Bank made FHLB advance payments totaling approximately \$0.4 million. No advances matured or were paid off in the first quarter of 2018, and we did not obtain any new FHLB advances during the quarter. 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 annually 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 \$288.4 million at March 31, 2018, compared to \$284.2 million at December 31, 2017 and \$278.1 million at March 31, 2017. Our leverage ratio was 10.36%, 10.47%, and 9.95%, respectively, for these periods. Further, at March 31, 2018, our risk-adjusted capital ratio was 17.05% compared to 17.10% and 16.44% at December 31, 2017 and March 31, 2017, respectively. Our common equity tier 1 ratio was 13.44% at March 31, 2018 compared to 13.42% and 12.77% at December 31, 2017 and March 31, 2017, respectively. All of our capital ratios exceeded the threshold to be designated as "well-capitalized" under the Basel III capital standards at March 31, 2018.

During the first three months of 2018, shareowners' equity increased \$4.2 million, or 5.9%, on an annualized basis. During this same period, shareowners' equity was positively impacted by net income of \$5.8 million, stock compensation accretion of \$0.3 million, and net adjustments totaling \$0.4 million related to transactions under our stock compensation plans. Shareowners' equity was reduced by common stock dividends totaling \$1.2 million and a \$1.1 million net increase in the unrealized loss on investment securities.

At March 31, 2018, our common stock had a book value of \$16.87 per diluted share compared to \$16.65 at December 31, 2017 and \$16.38 at March 31, 2017. Book value is impacted by changes in the amount of our net unrealized gain or loss on investment securities available-for-sale and changes to the amount of our unfunded pension liability both of which impact other comprehensive income. At March 31, 2018, the net unrealized loss on investment securities available for sale was \$2.8 million and the amount of our unfunded pension liability was \$30.3 million.

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 March 31, 2018, we were authorized to repurchase up to 640,000 additional shares under the plan.

## 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 March 31, 2018, we had \$473.4 million in commitments to extend credit and \$4.7 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)                               | March 31, 2018      |                     |                 | Three Months Ended<br>December 31, 2017 |                     |                 | March 31, 2017      |                     |                 |
|------------------------------------------------------|---------------------|---------------------|-----------------|-----------------------------------------|---------------------|-----------------|---------------------|---------------------|-----------------|
|                                                      | Average<br>Balances | Average<br>Interest | Average<br>Rate | Average<br>Balances                     | Average<br>Interest | Average<br>Rate | Average<br>Balances | Average<br>Interest | Average<br>Rate |
| <b>Assets:</b>                                       |                     |                     |                 |                                         |                     |                 |                     |                     |                 |
| Loans <sup>(1)(2)</sup>                              | \$ 1,647,612        | \$ 19,636           | 4.83%           | \$ 1,640,738                            | \$ 19,696           | 4.76%           | \$ 1,585,561        | \$ 18,137           | 4.76%           |
| Taxable Securities <sup>(2)</sup>                    | 619,137             | 2,523               | 1.64            | 602,353                                 | 2,263               | 1.50            | 600,528             | 1,784               | 1.50            |
| Tax-Exempt Securities                                | 84,800              | 318                 | 1.50            | 94,329                                  | 393                 | 1.67            | 97,965              | 396                 | 1.67            |
| Funds Sold                                           | 240,916             | 917                 | 1.54            | 174,565                                 | 594                 | 1.35            | 245,153             | 493                 | 1.35            |
| Total Earning Assets                                 | 2,592,465           | 23,394              | 3.66%           | 2,511,985                               | 22,946              | 3.63%           | 2,529,207           | 20,810              | 3.63%           |
| Cash & Due From Banks                                | 52,711              |                     |                 | 51,235                                  |                     |                 | 48,906              |                     |                 |
| Allowance For Loan Losses                            | (13,651)            |                     |                 | (13,524)                                |                     |                 | (13,436)            |                     |                 |
| Other Assets                                         | 260,595             |                     |                 | 272,755                                 |                     |                 | 280,463             |                     |                 |
| <b>TOTAL ASSETS</b>                                  | <b>\$ 2,892,120</b> |                     |                 | <b>\$ 2,822,451</b>                     |                     |                 | <b>\$ 2,845,140</b> |                     |                 |
| <b>Liabilities:</b>                                  |                     |                     |                 |                                         |                     |                 |                     |                     |                 |
| NOW Accounts                                         | \$ 863,175          | \$ 659              | 0.31%           | \$ 782,133                              | \$ 400              | 0.20%           | \$ 880,707          | \$ 134              | 0.20%           |
| Money Market Accounts                                | 246,576             | 103                 | 0.17            | 249,953                                 | 80                  | 0.13            | 259,106             | 35                  | 0.13            |
| Savings Accounts                                     | 343,987             | 42                  | 0.05            | 333,703                                 | 41                  | 0.05            | 311,212             | 38                  | 0.05            |
| Other Time Deposits                                  | 140,359             | 64                  | 0.18            | 145,622                                 | 69                  | 0.19            | 158,289             | 74                  | 0.19            |
| Total Interest Bearing Deposits                      | 1,594,097           | 868                 | 0.23            | 1,511,411                               | 590                 | 0.16            | 1,609,314           | 281                 | 0.16            |
| Short-Term Borrowings                                | 8,869               | 8                   | 0.37            | 8,074                                   | 5                   | 0.25            | 12,810              | 45                  | 0.25            |
| Subordinated Notes Payable                           | 52,887              | 475                 | 3.60            | 52,887                                  | 431                 | 3.19            | 52,887              | 379                 | 3.19            |
| Other Long-Term Borrowings                           | 13,787              | 100                 | 2.93            | 14,726                                  | 112                 | 3.01            | 14,468              | 99                  | 3.01            |
| Total Interest Bearing Liabilities                   | 1,669,640           | 1,451               | 0.37%           | 1,587,098                               | 1,138               | 0.29%           | 1,689,479           | 804                 | 0.29%           |
| Noninterest Bearing Deposits                         | 862,009             |                     |                 | 867,000                                 |                     |                 | 797,964             |                     |                 |
| Other Liabilities                                    | 72,969              |                     |                 | 80,309                                  |                     |                 | 79,208              |                     |                 |
| <b>TOTAL LIABILITIES</b>                             | <b>2,604,618</b>    |                     |                 | <b>2,534,407</b>                        |                     |                 | <b>2,566,651</b>    |                     |                 |
| <b>TOTAL SHAREOWNERS' EQUITY</b>                     | <b>287,502</b>      |                     |                 | <b>288,044</b>                          |                     |                 | <b>278,489</b>      |                     |                 |
| <b>TOTAL LIABILITIES AND<br/>SHAREOWNERS' EQUITY</b> | <b>\$ 2,892,120</b> |                     |                 | <b>\$ 2,822,451</b>                     |                     |                 | <b>\$ 2,845,140</b> |                     |                 |
| Interest Rate Spread                                 |                     |                     | 3.29%           |                                         |                     | 3.33%           |                     |                     |                 |
| Net Interest Income                                  |                     | \$ 21,943           |                 |                                         | \$ 21,808           |                 |                     | \$ 20,006           |                 |
| Net Interest Margin <sup>(3)</sup>                   |                     |                     | 3.43%           |                                         |                     | 3.45%           |                     |                     |                 |

<sup>(1)</sup>Average Balances include nonaccrual loans.<sup>(2)</sup>Interest income includes the effects of taxable equivalent adjustments using a 25% tax rate for 2018 and a 35% tax rate for 2017.<sup>(3)</sup>Taxable equivalent net interest income divided by average earnings assets.

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

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

**Item 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

At March 31, 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 March 31, 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: May 4, 2018