

CAPITAL CITY BANK GROUP INC  
Form 10-Q  
August 08, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the Quarterly Period Ended June 30, 2014**

**OR**

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

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

**Commission File Number: 0-13358**

(Exact name of registrant as specified in its charter)

**Florida**

(State or other jurisdiction of incorporation or organization)

**59-2273542**

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

**217 North Monroe Street, Tallahassee, Florida 32301**

(Address of principal executive office)

(Zip Code)

**(850) 402-7000**

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

(Registrant's telephone number, including area code)

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

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

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

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

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

At July 31, 2014, 17,449,460 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 JUNE 30, 2014**

**TABLE OF CONTENTS**

<b>PART I – Financial Information</b>		<b>Page</b>
<u>Item 1.</u>	<u>Consolidated Financial Statements (Unaudited)</u>	
	<u>Consolidated Statements of Financial Condition – June 30, 2014 and December 31, 2013</u>	4
	<u>Consolidated Statements of Operations – Three and Six Months Ended June 30, 2014 and 2013</u>	5
	<u>Consolidated Statements of Comprehensive Income – Three and Six Months Ended June 30, 2014 and 2013</u>	6
	<u>Consolidated Statements of Changes in Shareowners’ Equity – Six Months Ended June 30, 2014 and 2013</u>	7
	<u>Consolidated Statements of Cash Flows – Six Months Ended June 30, 2014 and 2013</u>	8
	<u>Notes to Consolidated Financial Statements</u>	9
<u>Item 2.</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	28
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosure About Market Risk</u>	45
<u>Item 4.</u>	<u>Controls and Procedures</u>	45
<b>PART II – Other Information</b>		
<u>Item 1.</u>	<u>Legal Proceedings</u>	45
<u>Item 1A.</u>	<u>Risk Factors</u>	45
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	46
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	46
<u>Item 4.</u>	<u>Mine Safety Disclosure</u>	46
<u>Item 5.</u>	<u>Other Information</u>	46
<u>Item 6.</u>	<u>Exhibits</u>	46
	<u>Signatures</u>	47

## 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, 2013 (the “2013 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:

- § legislative or regulatory changes, including the Dodd-Frank Act and Basel III;
- § our ability to successfully manage interest rate risk, liquidity risk, and other risks inherent to our industry;
- § the effects of security breaches and computer viruses that may affect our computer systems;
- § the accuracy of our financial statement estimates and assumptions, including the estimates used for our loan loss provision, deferred tax asset valuation allowance, and pension plan;
- § continued depression of the market value of the Company that could result in an impairment of goodwill;
- § the frequency and magnitude of foreclosure of our loans;
- § the effects of our lack of a diversified loan portfolio, including the risks of geographic and industry concentrations;
- § the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- § our need and our ability to incur additional debt or equity financing;
- § the effects of the health and soundness of other financial institutions;
- § our ability to declare and pay dividends and repurchase shares of the Company’s common stock under our repurchase plan;
- § 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;
- § our ability to comply with the laws of 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. CONSOLIDATED FINANCIAL STATEMENTS****CAPITAL CITY BANK GROUP, INC.****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

(Dollars in Thousands)	(Unaudited) June 30, 2014	December 31, 2013
<b>ASSETS</b>		
Cash and Due From Banks	\$63,956	\$ 55,209
Federal Funds Sold and Interest Bearing Deposits	354,233	474,719
Total Cash and Cash Equivalents	418,189	529,928
Investment Securities, Available for Sale, at fair value	275,082	251,420
Investment Securities, Held to Maturity, at amortized cost (fair value of \$180,318 and \$146,961)	180,393	148,211
Total Investment Securities	455,475	399,631
Loans Held For Sale	13,040	11,065
Loans, Net of Unearned Income	1,405,591	1,388,604
Allowance for Loan Losses	(20,543 )	(23,095 )
Loans, Net	1,385,048	1,365,509
Premises and Equipment, Net	102,141	103,385
Goodwill	84,811	84,811
Other Intangible Assets	—	32
Other Real Estate Owned	42,579	48,071
Other Assets	66,209	69,471
Total Assets	\$2,567,492	\$ 2,611,903
<b>LIABILITIES</b>		
Deposits:		
Noninterest Bearing Deposits	\$689,844	\$ 641,463
Interest Bearing Deposits	1,418,606	1,494,785
Total Deposits	2,108,450	2,136,248
Short-Term Borrowings	36,732	51,321
Subordinated Notes Payable	62,887	62,887
Other Long-Term Borrowings	33,282	38,043
Other Liabilities	44,561	47,004

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

Total Liabilities	2,285,912	2,335,503
SHAREOWNERS' EQUITY		
Preferred Stock, \$.01 par value; 3,000,000 shares authorized; no shares issued and outstanding	—	—
Common Stock, \$.01 par value; 90,000,000 shares authorized; 17,449,457 and 17,360,960 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively	174	174
Additional Paid-In Capital	41,628	41,152
Retained Earnings	248,142	243,614
Accumulated Other Comprehensive Loss, Net of Tax	(8,364 )	(8,540 )
Total Shareowners' Equity	281,580	276,400
Total Liabilities and Shareowners' Equity	\$2,567,492	\$2,611,903

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

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

(Dollars in Thousands, Except Per Share Data)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
<b>INTEREST INCOME</b>				
Loans, including Fees	\$18,152	\$19,709	\$36,250	\$39,863
Investment Securities:				
Taxable Securities	815	578	1,519	1,169
Tax Exempt Securities	124	132	267	245
Federal Funds Sold and Interest Bearing Deposits	257	279	548	549
Total Interest Income	19,348	20,698	38,584	41,826
<b>INTEREST EXPENSE</b>				
Deposits	293	367	601	782
Short-Term Borrowings	17	61	37	143
Subordinated Notes Payable	331	342	662	681
Other Long-Term Borrowings	269	333	560	680
Total Interest Expense	910	1,103	1,860	2,286
<b>NET INTEREST INCOME</b>	18,438	19,595	36,724	39,540
Provision for Loan Losses	499	1,450	858	2,520
Net Interest Income After Provision For Loan Losses	17,939	18,145	35,866	37,020
<b>NONINTEREST INCOME</b>				
Deposit Fees	6,213	6,217	12,082	12,382
Bank Card Fees	2,820	2,754	5,527	5,415
Wealth Management Fees	1,852	1,901	3,770	3,816
Mortgage Banking Fees	738	968	1,363	2,011
Data Processing Fees	388	670	929	1,323
Other	1,336	1,221	2,461	2,313
Total Noninterest Income	13,347	13,731	26,132	27,260
<b>NONINTEREST EXPENSE</b>				
Compensation	15,206	16,647	30,987	33,386
Occupancy, net	4,505	4,161	8,803	8,579
Intangible Amortization	—	48	32	116
Other Real Estate Owned, net	2,276	2,290	3,675	5,115
Other	7,089	7,318	13,945	14,409
Total Noninterest Expense	29,076	30,464	57,442	61,605
<b>INCOME BEFORE INCOME TAXES</b>	2,210	1,412	4,556	2,675
Income Tax Expense (Benefit)	737	569	(668)	993
<b>NET INCOME</b>	\$1,473	\$843	\$5,224	\$1,682



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

BASIC NET INCOME PER SHARE	\$0.08	\$0.05	\$0.30	\$0.10
DILUTED NET INCOME PER SHARE	\$0.08	\$0.05	\$0.30	\$0.10
Average Basic Shares Outstanding	17,427	17,319	17,413	17,311
Average Diluted Shares Outstanding	17,488	17,355	17,463	17,364

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

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

(Dollars in Thousands)	Three Months		Six Months	
	Ended June 30, 2014	2013	Ended June 30, 2014	2013
NET INCOME	\$1,473	\$843	\$5,224	\$1,682
Other comprehensive income (loss), before tax:				
Change in net unrealized gain/loss	257	(1,615)	252	(1,608)
Amortization of unrealized losses on securities transferred from available for sale to held to maturity	16	—	36	—
Reclassification adjustment for impairment loss realized in net income	—	200	—	200
Other comprehensive income (loss), before tax	273	(1,415)	288	(1,408)
Deferred tax expense (benefit) related to other comprehensive income	105	(623 )	112	(622 )
Other comprehensive income (loss), net of tax	168	(792 )	176	(786 )
TOTAL COMPREHENSIVE INCOME	\$1,641	\$51	\$5,400	\$896

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

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

	Shares Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss, Net of Taxes	Total
<i>(Dollars In Thousands, Except Share Data)</i>						
Balance, January 1, 2013	17,232,380	\$ 172	\$ 38,707	\$ 237,569	\$ (29,559 )	\$ 246,889
Net Income		—	—	1,682	—	1,682
Other Comprehensive Income, Net of Tax		—	—	—	(786 )	(786 )
Stock Based Compensation		—	643	—	—	643
Impact of Transactions Under Compensation Plans, net	103,889	1	860	—	—	861
Balance, June 30, 2013	17,336,269	\$ 173	\$ 40,210	\$ 239,251	\$ (30,345 )	\$ 249,289
Balance, January 1, 2014	17,360,960	\$ 174	\$ 41,152	\$ 243,614	\$ (8,540 )	\$ 276,400
Net Income		—	—	5,224	—	5,224
Other Comprehensive Income, Net of Tax		—	—	—	176	176
Cash Dividends (\$0.0400 per share)		—	—	(696 )	—	(696 )
Stock Based Compensation		—	526	—	—	526
Impact of Transactions Under Compensation Plans, net	88,497	—	(50 )	—	—	(50 )
Balance, June 30, 2014	17,449,457	\$ 174	\$ 41,628	\$ 248,142	\$ (8,364 )	\$ 281,580

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

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

(Dollars in Thousands)	Six Months Ended June	
	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	\$5,224	\$1,682
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities:		
Provision for Loan Losses	858	2,520
Depreciation	3,246	3,237
Amortization of Premiums, Discounts, and Fees (net)	2,521	2,111
Amortization of Intangible Assets	32	116
Impairment Loss on Security	—	200
Net Increase in Loans Held-for-Sale	(1,975 )	(1,173 )
Stock Based Compensation	526	643
Deferred Income Taxes	1,390	1,557
Loss on Sales and Write-Downs of Other Real Estate Owned	2,382	3,316
Net Decrease (Increase) in Other Assets	1,796	(398 )
Net (Decrease) Increase in Other Liabilities	(2,834 )	6,309
Net Cash Provided By Operating Activities	13,166	20,120
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Securities Held to Maturity:		
Purchases	(51,311 )	—
Payments, Maturities, and Calls	18,325	—
Securities Available for Sale:		
Purchases	(89,578 )	(127,329)
Payments, Maturities, and Calls	64,239	69,743
Net (Increase) Decrease in Loans	(29,452 )	55,507
Proceeds From Sales of Other Real Estate Owned	12,377	12,357
Purchases of Premises and Equipment	(2,002 )	(888 )
Net Cash (Used In) Provided By Investing Activities	(77,402 )	9,390
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net Decrease in Deposits	(27,798 )	(73,873 )
Net Decrease in Short-Term Borrowings	(15,829 )	(5,782 )
Increase in Other Long-Term Borrowings		1,303
Repayment of Other Long-Term Borrowings	(3,521 )	(2,483 )
Dividends Paid	(696 )	—
Issuance of Common Stock Under Compensation Plans	341	861
Net Cash Used In Financing Activities	(47,503 )	(79,974 )
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(111,739)</b>	<b>(50,464 )</b>

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

Cash and Cash Equivalents at Beginning of Period	529,928	509,732
Cash and Cash Equivalents at End of Period	\$418,189	\$459,268
Supplemental Cash Flow Disclosures:		
Interest Paid	\$1,915	\$1,643
Income Taxes Paid	\$2,635	\$(286 )
Noncash Investing and Financing Activities:		
Loans Transferred to Other Real Estate Owned	\$9,267	\$17,334
Transfer of Current Portion of Long-Term Borrowings	\$1,240	\$4,428

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

**CAPITAL CITY BANK GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

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

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

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

The consolidated statement of financial condition at December 31, 2013 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, 2013.

**NOTE 2 - INVESTMENT SECURITIES**

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

**June 30, 2014**

**December 31, 2013**

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

	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value	Amortized Cost	Unrealized Gain	Unrealized Losses	Market Value
Available for Sale								
U.S. Treasury	\$ 114,457	\$ 212	\$ 2	\$ 114,667	\$ 71,791	\$ 82	\$ 40	\$ 71,833
U.S. Government Agency States and Political Subdivisions	89,049	217	264	89,002	75,275	127	256	75,146
Mortgage-Backed Securities	59,858	138	13	59,983	91,605	167	19	91,753
Other Securities <sup>(1)</sup>	2,448	237	—	2,685	2,583	212	—	2,795
Total	8,745	—	—	8,745	9,893	—	—	9,893
	274,557	\$ 804	\$ 279	\$ 275,082	\$ 251,147	\$ 588	\$ 315	\$ 251,420
Held to Maturity								
U.S. Treasury	\$ 71,357	\$ 204	\$ —	\$ 71,561	\$ 43,533	\$ 84	\$ 38	\$ 43,579
U.S. Government Agency States and Political Subdivisions	27,838	55	17	27,876	15,794	38	22	15,810
Mortgage-Backed Securities	32,945	78	3	33,020	33,216	53	4	33,265
Other Securities	48,253	27	419	47,861	55,668	12	1,373	54,307
Total	—	—	—	—	—	—	—	—
	\$ 180,393	\$ 364	\$ 439	\$ 180,318	\$ 148,211	\$ 187	\$ 1,437	\$ 146,961

<sup>(1)</sup> Includes Federal Home Loan Bank and Federal Reserve Bank stock recorded at cost of \$3.9 million and \$4.8 million, respectively, at June 30, 2014 and \$5.0 million and \$4.8 million, respectively, at December 31, 2013.

Securities with an amortized cost of \$243.9 million and \$258.5 million at June 30, 2014 and December 31, 2013, respectively, were pledged to secure public deposits and for other purposes.

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

*Maturity Distribution.* As of June 30, 2014, 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.

(Dollars in Thousands)	Available for Sale		Held to Maturity	
	Amortized Cost	Market Value	Amortized Cost	Market Value
Due in one year or less	\$76,160	\$76,263	\$18,839	\$18,859
Due after one through five years	117,319	117,564	113,301	113,598
No Maturity	8,745	8,745	—	—
U.S. Government Agency	69,885	69,825	—	—
Mortgage-Backed Securities	2,448	2,685	48,253	47,861
Total	\$274,557	\$275,082	\$180,393	\$180,318

*Unrealized Losses on Investment Securities.* The following table summarizes the investment securities with unrealized losses at June 30, 2014, aggregated by major security type and length of time in a continuous unrealized loss position:

(Dollars in Thousands)	Less Than 12 Months		Greater Than 12 Months		Total	
	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
<b>June 30, 2014</b>						
<b>Available for Sale</b>						
U.S. Government Treasury	\$14,916	\$ 2	\$—	\$ —	\$14,916	\$ 2
U.S. Government Agency	24,074	166	13,379	98	37,453	264
States and Political Subdivisions	1,071	4	1,255	9	2,326	13
Total	\$40,061	\$ 172	\$14,634	\$ 107	\$54,695	\$ 279
<b>Held to Maturity</b>						
U.S. Government Treasury	\$5,031	\$ —	\$—	\$ —	\$5,031	\$ —
U.S. Government Agency	8,013	17	—	—	8,013	17
States and Political Subdivisions	4,044	3	—	—	4,044	3
Mortgage-Backed Securities	34,154	363	3,470	56	37,624	419
Total	\$51,242	\$ 383	\$3,470	\$ 56	\$54,712	\$ 439
<b>December 31, 2013</b>						
<b>Available for Sale</b>						
U.S. Government Treasury	\$24,924	\$ 40	\$—	\$ —	\$24,924	\$ 40
U.S. Government Agency	40,944	235	4,842	21	45,786	256
States and Political Subdivisions	4,101	7	511	12	4,612	19
Total	\$69,969	\$ 282	\$5,353	\$ 33	\$75,322	\$ 315
<b>Held to Maturity</b>						
U.S. Government Treasury	\$10,054	\$ 38	\$—	\$ —	\$10,054	\$ 38



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

U.S. Government Agency	5,676	22	—	—	5,676	22
States and Political Subdivisions	3,316	4	—	—	3,316	4
Mortgage-Backed Securities	44,031	1,373	—	—	44,031	1,373
Total	\$63,077	\$ 1,437	\$—	\$ —	\$63,077	\$ 1,437

Management evaluates securities for other than temporary impairment at least quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to: 1) the length of time and the extent to which the fair value has been less than amortized cost, 2) the financial condition and near-term prospects of the issuer, and 3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in cost. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by rating agencies have occurred, regulatory issues, and analysts' reports.

Approximately \$14.6 million of investment securities, with an unrealized loss of approximately \$107,000, have been in a loss position for greater than 12 months. These debt securities are in a loss position because they were acquired when the general level of interest rates was lower than that on June 30, 2014. The Company believes that the unrealized losses in these debt securities are temporary in nature and that the full principal will be collected as anticipated. Because the declines in the market value of these investments are attributable to changes in interest rates and not credit quality and because the Company has the present ability and intent to hold these investments until there is a recovery in fair value, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2014.

### NOTE 3 – LOANS, NET

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

(Dollars in Thousands)	June 30, 2014	December 31, 2013
Commercial, Financial and Agricultural	\$ 134,833	\$ 126,607
Real Estate – Construction	34,244	31,012
Real Estate – Commercial Mortgage	518,580	533,871
Real Estate – Residential <sup>(1)</sup>	305,829	309,692
Real Estate – Home Equity	228,232	227,922
Consumer	183,873	159,500
Loans, Net of Unearned Income	\$ 1,405,591	\$ 1,388,604

<sup>(1)</sup> *Includes loans in process with outstanding balances of \$7.9 million and \$6.8 million at June 30, 2014 and December 31, 2013, respectively.*

Net deferred fees included in loans were \$1.5 million at June 30, 2014 and December 31, 2013.

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.

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

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

(Dollars in Thousands)	June 30, 2014		December 31, 2013	
	Nonaccrual	90 + Days	Nonaccrual	90 + Days
Commercial, Financial and Agricultural	\$ 187	—	\$ 188	—
Real Estate – Construction	846	—	426	—
Real Estate – Commercial Mortgage	14,089	—	25,227	—
Real Estate – Residential	7,267	—	6,440	—
Real Estate – Home Equity	2,784	—	4,084	—
Consumer	497	—	599	—
Total Nonaccrual Loans	\$25,670	—	\$36,964	—

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

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

<i>(Dollars in Thousands)</i>	<b>30-59 DPD</b>	<b>60-89 DPD</b>	<b>90 + DPD</b>	<b>Total Past Due</b>	<b>Total Current</b>	<b>Total Loans</b>
June 30, 2014						
Commercial, Financial and Agricultural	\$62	\$217	\$ —	\$279	\$134,367	\$134,833
Real Estate – Construction	—	—	—	—	33,398	34,244
Real Estate – Commercial Mortgage	1,180	55	—	1,235	503,256	518,580
Real Estate – Residential	1,363	668	—	2,031	296,531	305,829
Real Estate – Home Equity	689	119	—	808	224,640	228,232
Consumer	555	184	—	739	182,637	183,873
Total Past Due Loans	\$3,849	\$1,243	\$ —	\$5,092	\$1,374,829	\$1,405,591
December 31, 2013						
Commercial, Financial and Agricultural	\$258	\$100	\$ —	\$358	\$126,062	\$126,607
Real Estate – Construction	—	—	—	—	30,587	31,012
Real Estate – Commercial Mortgage	1,548	672	—	2,220	506,424	533,871
Real Estate – Residential	1,647	1,090	—	2,737	300,514	309,692
Real Estate – Home Equity	848	212	—	1,060	222,778	227,922
Consumer	1,127	244	—	1,371	157,529	159,500
Total Past Due Loans	\$5,428	\$2,318	\$ —	\$7,746	\$1,343,894	\$1,388,604

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

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

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

<i>(Dollars in Thousands)</i>	<b>Commercial Financial, Agricultural</b>	<b>Real Estate Construction</b>	<b>Real Estate Commercial Mortgage</b>	<b>Real Estate Residential</b>	<b>Real Estate Home Equity</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
<b>Three Months Ended</b>								
<b>June 30, 2014</b>								
Beginning Balance	\$ 633	\$ 1,842	\$ 7,080	\$ 8,842	\$ 2,853	\$ 860	\$ —	\$ 22,110
Provision for Loan Losses	114	(576 )	(56 )	15	523	479	—	499
Charge-Offs	(86 )	—	(1,029 )	(695 )	(375 )	(421 )	—	(2,606 )
Recoveries	45	1	152	52	65	225	—	540
Net Charge-Offs	(41 )	1	(877 )	(643 )	(310 )	(196 )	—	(2,066 )
Ending Balance	\$ 706	\$ 1,267	\$ 6,147	\$ 8,214	\$ 3,066	\$ 1,143	\$ —	\$ 20,543
<b>Six Months Ended</b>								
<b>June 30, 2014</b>								
Beginning Balance	\$ 699	\$ 1,580	\$ 7,710	\$ 9,073	\$ 3,051	\$ 982	\$ —	\$ 23,095
Provision for Loan Losses	(16 )	(318 )	(119 )	120	717	474	—	858
Charge-Offs	(97 )	—	(1,623 )	(1,426 )	(778 )	(826 )	—	(4,750 )
Recoveries	120	5	179	447	76	513	—	1,340
Net Charge-Offs	23	5	(1,444 )	(979 )	(702 )	(313 )	—	(3,410 )
Ending Balance	\$ 706	\$ 1,267	\$ 6,147	\$ 8,214	\$ 3,066	\$ 1,143	\$ —	\$ 20,543
<b>Three Months Ended</b>								
<b>June 30, 2013</b>								
Beginning Balance	\$ 857	\$ 2,387	\$ 10,998	\$ 8,266	\$ 3,077	\$ 1,218	\$ 1,000	\$ 27,803
Provision for Loan Losses	119	(34 )	(141 )	1,649	(100 )	(69 )	26	1,450
Charge-Offs	(119 )	(110 )	(1,050 )	(1,053 )	(322 )	(351 )	—	(3,005 )
Recoveries	38	—	144	396	224	244	—	1,046
Net Charge-Offs	(81 )	(110 )	(906 )	(657 )	(98 )	(107 )	—	(1,959 )
Ending Balance	\$ 895	\$ 2,243	\$ 9,951	\$ 9,258	\$ 2,879	\$ 1,042	\$ 1,026	\$ 27,294
<b>Six Months Ended</b>								
<b>June 30, 2013</b>								
Beginning Balance	\$ 1,253	\$ 2,856	\$ 11,081	\$ 8,678	\$ 2,945	\$ 1,327	\$ 1,027	\$ 29,167
Provision for Loan Losses	(174 )	107	781	1,824	127	(144 )	(1 )	2,520

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

Charge-Offs	(273	)	(720	)	(2,093	)	(1,736	)	(435	)	(647	)	—	(5,904)
Recoveries	89		—		182		492		242		506		—	1,511
Net Charge-Offs	(184	)	(720	)	(1,911	)	(1,244	)	(193	)	(141	)	—	(4,393)
Ending Balance	\$ 895		\$ 2,243		\$ 9,951		\$ 9,258		\$ 2,879		\$ 1,042		\$ 1,026	\$ 27,294

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

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

(Dollars in Thousands)	Commercial Financial, Agricultural	Real Estate Construction	Real Estate Commercial Mortgage	Real Estate Residential	Real Estate Home Equity	Consumer	Unallocated	Total
June 30, 2014								
Period-end amount								
Allocated to:								
Loans Individually Evaluated for Impairment	\$ 185	\$ 63	\$ 3,565	\$ 2,563	\$ 305	\$ 20	\$ —	\$ 6,701
Loans Collectively Evaluated for Impairment	521	1,204	2,582	5,651	2,761	1,123	—	13,842
Ending Balance	\$ 706	\$ 1,267	\$ 6,147	\$ 8,214	\$ 3,066	\$ 1,143	\$ —	\$ 20,543
December 31, 2013								
Period-end amount								
Allocated to:								
Loans Individually Evaluated for Impairment	\$ 75	\$ 66	\$ 4,336	\$ 2,047	\$ 682	\$ 23	\$ —	\$ 7,229
Loans Collectively Evaluated for Impairment	624	1,514	3,374	7,026	2,369	959	—	15,866
Ending Balance	\$ 699	\$ 1,580	\$ 7,710	\$ 9,073	\$ 3,051	\$ 982	\$ —	\$ 23,095
June 30, 2013								
Period-end amount								
Allocated to:								
Loans Individually Evaluated for Impairment	\$ 238	\$ 160	\$ 6,022	\$ 2,542	\$ 524	\$ 60	\$ —	\$ 9,546
Loans Collectively Evaluated for Impairment	657	2,083	3,929	6,716	2,355	982	1,026	17,748
Ending Balance	\$ 895	\$ 2,243	\$ 9,951	\$ 9,258	\$ 2,879	\$ 1,042	\$ 1,026	\$ 27,294

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

(Dollars in Thousands)	Commercial Financial,	Real Estate Construction	Real Estate Commercial	Real Estate Residential	Real Estate	Consumer	Unallocated	Total
---------------------------	--------------------------	-----------------------------	---------------------------	----------------------------	----------------	----------	-------------	-------

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

	Agricultural		Mortgage		Home Equity			
June 30, 2014								
Individually Evaluated for Impairment	\$ 1,378	\$ 821	\$ 40,516	\$ 22,273	\$ 2,563	\$ 315	\$ —	\$ 67,866
Collectively Evaluated for Impairment	133,455	33,423	478,064	283,556	225,669	183,558	—	1,337,725
Total	\$ 134,833	\$ 34,244	\$ 518,580	\$ 305,829	\$ 228,232	\$ 183,873	\$ —	\$ 1,405,591
December 31, 2013								
Individually Evaluated for Impairment	\$ 1,580	\$ 557	\$ 49,973	\$ 20,470	\$ 3,359	\$ 355	\$ —	\$ 76,294
Collectively Evaluated for Impairment	125,027	30,455	483,898	289,222	224,563	159,145	—	1,312,310
Total	\$ 126,607	\$ 31,012	\$ 533,871	\$ 309,692	\$ 227,922	\$ 159,500	\$ —	\$ 1,388,604
June 30, 2013								
Individually Evaluated for Impairment	\$ 1,955	\$ 1,097	\$ 61,494	\$ 21,090	\$ 4,124	\$ 526	\$ —	\$ 90,286
Collectively Evaluated for Impairment	124,976	34,726	520,007	287,068	228,406	144,648	—	1,339,831
Total	\$ 126,931	\$ 35,823	\$ 581,501	\$ 308,158	\$ 232,530	\$ 145,174	\$ —	\$ 1,430,117



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

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

<i>(Dollars in Thousands)</i>	Unpaid Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Related Allowance
June 30, 2014				
Commercial, Financial and Agricultural	\$ 1,378	\$ 200	\$ 1,178	\$ 185
Real Estate – Construction	821	401	421	63
Real Estate – Commercial Mortgage	40,516	11,585	28,931	3,563
Real Estate – Residential	22,273	5,564	16,708	2,563
Real Estate – Home Equity	2,563	809	1,754	305
Consumer	315	96	219	20
Total	\$67,866	\$ 18,655	\$ 49,211	\$ 6,701
December 31, 2013				
Commercial, Financial and Agricultural	\$ 1,580	\$ 443	\$ 1,137	\$ 75
Real Estate – Construction	557	—	557	66
Real Estate – Commercial Mortgage	49,973	19,860	30,113	4,336
Real Estate – Residential	20,470	4,330	16,140	2,047
Real Estate – Home Equity	3,359	646	2,713	682
Consumer	355	90	265	23
Total	\$76,294	\$ 25,369	\$ 50,925	\$ 7,229

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

<i>(Dollars in Thousands)</i>	Three Months Ended June 30,				Six Months Ended June 30,			
	2014		2013		2014		2013	
	Average Recorded Investmen	Total Interest Income	Average Recorded Investmen	Total Interest Income	Average Recorded Investmen	Total Interest Income	Average Recorded Investmen	Total Interest Income
Commercial, Financial and Agricultural	\$1,482	\$ 17	\$2,176	\$ 33	\$1,514	\$35	\$2,226	\$76
Real Estate - Construction	689	1	1,589	2	645	2	2,469	3
Real Estate - Commercial Mortgage	45,215	389	62,267	524	46,801	917	66,395	1,065
Real Estate - Residential	21,558	307	21,582	213	21,195	517	22,065	419
Real Estate - Home Equity	2,768	17	4,096	16	2,965	34	4,017	36
Consumer	338	2	587	3	344	5	620	5

Total	\$72,050	\$ 733	\$92,297	\$ 791	\$73,464	\$1,510	\$97,792	\$1,604
-------	----------	--------	----------	--------	----------	---------	----------	---------

15

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

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

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

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

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

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

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

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

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

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

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

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

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

(Dollars in Thousands)	Commercial, Financial, Agriculture	Real Estate	Consumer	Total Criticized Loans
June 30, 2014				
Special Mention	\$ 4,821	\$44,384	\$ 155	\$49,360
Substandard	4,292	89,722	1,023	95,037
Doubtful	—	—	—	—
Total Criticized Loans	\$ 9,113	\$ 134,106	\$ 1,178	\$ 144,397
December 31, 2013				
Special Mention	\$ 3,656	\$45,870	\$ 115	\$49,641
Substandard	4,243	108,990	1,496	114,729
Doubtful	—	900	—	900
Total Criticized Loans	\$ 7,899	\$ 155,760	\$ 1,611	\$ 165,270

*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. In the limited circumstances that a loan is removed from TDR classification it is the Company’s policy to also remove it from the impaired loan category, but to continue to individually evaluate loan impairment based on the contractual terms specified by the loan agreement.

The following table presents loans classified as TDRs.

(Dollars in Thousands)	June 30, 2014		December 31, 2013	
	<b>Accruing</b>	<b>Nonaccruing</b>	<b>Accruing</b>	<b>Nonaccruing</b>
Commercial, Financial and Agricultural	\$1,317	\$ —	\$1,511	\$ —
Real Estate – Construction	—	—	156	—
Real Estate – Commercial Mortgage	25,854	4,116	24,735	10,308
Real Estate – Residential	16,459	1,478	16,441	458
Real Estate – Home Equity	1,500	184	1,576	241
Consumer	310	—	345	—
Total TDRs	\$45,440	\$ 5,778	\$44,764	\$ 11,007

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.

(Dollars in Thousands)	Three Months Ended June 30, 2014			Six Months Ended June 30, 2014		
	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment
Commercial, Financial and Agricultural	—	\$ —	\$ —	1	\$ 51	\$ 54
Real Estate – Construction	—	—	—	—	—	—
Real Estate - Commercial Mortgage	1	60	60	2	644	644
Real Estate – Residential	3	271	317	6	1,107	1,207
Real Estate - Home Equity	—	—	—	3	248	248
Consumer	—	—	—	1	34	34
Total TDRs	4	\$ 331	\$ 377	13	\$ 2,084	\$ 2,187

(Dollars in Thousands)	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment
Commercial, Financial and Agricultural	2	\$ 268	\$ 259	4	\$ 294	\$ 337
Real Estate – Construction	—	—	—	—	—	—
Real Estate - Commercial Mortgage	4	734	721	9	5,121	5,153
Real Estate – Residential	7	804	833	10	1,176	1,214
Real Estate - Home Equity	5	256	252	6	344	342
Consumer	5	77	60	6	112	93
Total TDRs	23	\$ 2,139	\$ 2,125	35	\$ 7,047	\$ 7,139

Loans modified as TDRs within the previous 12 months that have subsequently defaulted during the periods indicated are presented in the table below.

(Dollars in Thousands)	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	Number of Contracts	Post-Modified Recorded Investment	Number of Contracts	Post-Modified Recorded Investment
Commercial, Financial and Agricultural	—	\$ —	—	\$ —
Real Estate - Construction	—	—	—	—
Real Estate - Commercial Mortgage	—	—	—	—
Real Estate - Residential	1	118	1	118
Real Estate - Home Equity	1	153	1	153
Consumer	—	—	—	—
Total TDRs	2	\$ 271	2	\$ 271

(Dollars in Thousands)	Three Months Ended June 30, 2013		Six Months Ended June 30, 2013	
	Number of Contracts	Post-Modified Recorded Investment	Number of Contracts	Post-Modified Recorded Investment
Commercial, Financial and Agricultural	1	\$ 83	1	\$ 83
Real Estate - Construction	—	—	—	—
Real Estate - Commercial Mortgage	3	988	5	1,216
Real Estate - Residential	1	264	2	283
Real Estate - Home Equity	—	—	—	—
Consumer	1	28	1	28
Total TDRs	6	\$ 1,363	9	\$ 1,610

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

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

(Dollars in Thousands)	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	Number of Contracts	Recorded Investment <sup>(1)</sup>	Number of Contracts	Recorded Investment <sup>(1)</sup>
Extended amortization	3	\$ 317	6	\$ 1,579
Interest rate adjustment	—	—	1	156



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

Extended amortization and interest rate adjustment	1	60	3	257
Other	—	—	3	195
Total TDRs	4	\$ 377	13	\$ 2,187

(Dollars in Thousands)	Three Months Ended June 30, 2013		Six Months Ended June 30, 2013	
	Number of Contracts	<b>Recorded Investment<sup>(1)</sup></b>	Number of Contracts	<b>Recorded Investment<sup>(1)</sup></b>
Extended amortization	5	\$ 440	8	\$ 818
Interest rate adjustment	4	329	6	654
Extended amortization and interest rate adjustment	7	540	11	4,683
Other	7	816	10	984
Total TDRs	23	\$ 2,125	35	\$ 7,139

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

**NOTE 4 - INTANGIBLE ASSETS**

The Company had net intangible assets of \$84.8 million at June 30, 2014 and December 31, 2013, respectively. Intangible assets were as follows:

(Dollars in Thousands)	June 30, 2014		December 31, 2013	
	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Core Deposit Intangibles	\$47,176	\$ 47,176	\$47,176	\$ 47,176
Goodwill	84,811	—	84,811	—
Customer Relationship Intangible	1,867	1,867	1,867	1,835
Total Intangible Assets	\$133,854	\$ 49,043	\$133,854	\$ 49,011

*Goodwill:* As of June 30, 2014 and December 31, 2013, the Company had goodwill, net of accumulated amortization, of \$84.8 million. Goodwill is tested for impairment on an annual basis, or more often if impairment indicators exist. A goodwill impairment test consists of two steps. Step One compares the estimated fair value of the reporting unit to its carrying amount. If the carrying amount exceeds the estimated fair value, Step Two is performed by comparing the fair value of the reporting unit's implied goodwill to the carrying value of goodwill. If the carrying value of the reporting unit's goodwill exceeds the estimated fair value, an impairment charge is recorded equal to the excess.

As of June 30, 2014, the Company's net book value, including goodwill, exceeded its market capitalization, and as such, the Company performed goodwill impairment testing. The Step One test indicated that the carrying amount (including goodwill) of the Company's reporting unit was less than its estimated fair value; therefore, no impairment was recorded. The Company will continue to evaluate goodwill for impairment as defined by ASC Topic 350.

**NOTE 5 – OTHER REAL ESTATE OWNED**

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

(Dollars in Thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Beginning Balance	\$44,036	\$58,421	\$48,071	\$53,426
Additions	7,977	4,355	9,267	17,334
Valuation Write-downs	(822 )	(1,060 )	(1,552 )	(2,205 )
Sales	(8,612 )	(6,629 )	(13,207 )	(13,369 )
Other	—	—	—	(99 )

Ending Balance      \$42,579   \$55,087   \$42,579   \$55,087

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

(Dollars in Thousands)	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2014	2013	2014	2013
Gains from the Sale of Properties	\$(88 )	\$(118 )	\$(334 )	\$(178 )
Losses from the Sale of Properties	808	491	1,165	1,289
Rental Income from Properties	(60 )	(111 )	(275 )	(127 )
Property Carrying Costs	794	968	1,567	1,926
Valuation Adjustments	822	1,060	1,552	2,205
Total	\$2,276	\$2,290	\$3,675	\$5,115

**NOTE 6 - DEPOSITS**

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

(Dollars in Thousands)	June 30, 2014	December 31, 2013
NOW Accounts	\$ 712,385	\$ 794,746
Money Market Accounts	272,255	268,449
Savings Deposits	227,470	211,668
Other Time Deposits	206,496	219,922
Total Interest Bearing Deposits	\$ 1,418,606	\$ 1,494,785

**NOTE 7 - EMPLOYEE BENEFIT PLANS**

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

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

(Dollars in Thousands)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Service Cost	\$1,500	\$1,875	\$3,000	\$3,750
Interest Cost	1,400	1,400	2,800	2,800
Expected Return on Plan Assets	(1,875)	(1,825)	(3,750)	(3,650)
Prior Service Cost Amortization	75	75	150	150
Net Loss Amortization	325	1,075	650	2,150
Net Periodic Cost	\$1,425	\$2,600	\$2,850	\$5,200
Discount Rate	5.00 %	4.25 %	5.00 %	4.25 %
Long-Term Rate of Return on Assets	7.50 %	8.00 %	7.50 %	8.00 %

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

(Dollars in Thousands)	Three Months		Six Months	
	Ended June 30, 2014	2013	Ended June 30, 2014	2013

Interest Cost	\$28	\$35	\$55	\$70
Prior Service Cost Amortization	40	48	80	96
Net Gain Amortization	(183)	(63 )	(365)	(126)
Net Periodic (Income) Cost	\$(115)	\$20	\$(230)	\$40
Discount Rate	5.00 %	4.25 %	5.00 %	4.25 %

**NOTE 8 - COMMITMENTS AND CONTINGENCIES**

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

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

(Dollars in Thousands)	June 30, 2014			December 31, 2013		
	Fixed	Variable	Total	Fixed	Variable	Total
Commitments to Extend Credit <sup>(1)</sup>	\$68,269	\$243,809	\$312,078	\$36,927	\$234,342	\$271,269
Standby Letters of Credit	8,921	—	8,921	10,979	—	10,979
Total	\$77,190	\$243,809	\$320,999	\$47,906	\$234,342	\$282,248

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

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

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

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

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

*Indemnification Obligation.* The Company is a member of the Visa U.S.A. network. Visa U.S.A believes that its member banks are required to indemnify it for potential future settlement of certain litigation (the "Covered Litigation") that relates to several antitrust lawsuits challenging the practices of Visa and MasterCard International. In 2008, the Company, as a member of the Visa U.S.A. network, obtained Class B shares of Visa, Inc. upon its initial public offering. Since its initial public offering, Visa, Inc. has funded a litigation reserve for the Covered Litigation resulting in a reduction in the Class B shares held by the Company. During the first quarter of 2011, the Company sold its remaining Class B shares resulting in a \$3.2 million pre-tax gain. Associated with this sale, the Company entered into a swap contract with the purchaser of the shares that requires a payment to the counterparty in the event that Visa, Inc. makes subsequent revisions to the conversion ratio for its Class B shares.

In December 2013, a settlement agreement was approved by the court in resolution of the aforementioned Covered Litigation matter. Visa's share of the settlement is to be paid from the litigation reserve account. Based on the aforementioned settlement agreement, the Company does not expect to make any additional payments to the counterparty other than certain fixed charges included in the liability, which are payable quarterly until the litigation reserve is fully liquidated and at which time the aforementioned swap contract will be terminated. Quarterly payments average approximately \$50,000. Conversion ratio payments and ongoing fixed quarterly charges are reflected in earnings in the period incurred.

## NOTE 9 – FAIR VALUE MEASUREMENTS

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

§ *Level 1 Inputs* - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

§ *Level 2 Inputs* - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from, or corroborated, by market data by correlation or other means.

§ *Level 3 Inputs* - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

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

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

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

*Fair Value Swap.* The Company entered into a stand-alone derivative contract with the purchaser of its Visa Class B shares. The valuation represents an internally developed estimate of the exposure based upon probability-weighted potential Visa litigation losses and related carrying cost obligations required under the contract.

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

(Dollars in Thousands)	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
June 30, 2014				
Securities Available for Sale:				
U.S. Treasury	\$ 114,667	\$—	\$ —	\$ 114,667
U.S. Government Agency	—	89,002	—	89,002
States and Political Subdivisions	—	59,983	—	59,983
Mortgage-Backed Securities	—	2,685	—	2,685
Other Securities	—	8,745	—	8,745
December 31, 2013				
Securities Available for Sale:				
U.S. Treasury	\$ 71,833	\$—	\$ —	\$ 71,833
U.S. Government Agency	—	75,146	—	75,146
State and Political Subdivisions	—	91,753	—	91,753
Mortgage-Backed Securities	—	2,795	—	2,795
Other Securities	—	9,893	—	9,893



### **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 \$30.1 million with a valuation allowance of \$3.5 million at June 30, 2014 and \$31.5 million and \$3.1 million, respectively, at December 31, 2013.

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

*Other Real Estate Owned.* During the first six months of 2014, certain foreclosed assets, upon initial recognition, were measured and reported at fair value through a charge-off to the allowance for loan losses based on the fair value of the foreclosed asset less estimated cost to sell. The fair value of the foreclosed asset is determined by an independent valuation or professional appraisal in conformance with banking regulations. On an ongoing basis, we obtain updated appraisals on foreclosed assets and realize valuation adjustments as necessary. The fair value of foreclosed assets is estimated using Level 3 inputs due to the judgment and estimation involved in the real estate valuation process.

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

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

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

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

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

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

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

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

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

(Dollars in Thousands)	June 30, 2014			
	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
<b>ASSETS:</b>				
Cash	\$63,956	\$63,956	\$—	\$—
Short-Term Investments	354,233	354,233	—	—
Investment Securities, Available for Sale	275,082	114,667	160,415	—
Investment Securities, Held to Maturity	180,393	71,561	108,757	—
Loans Held for Sale	13,040	—	13,040	—
Loans, Net of Allowance for Loan Losses	1,385,048	—	—	1,315,496
<b>LIABILITIES:</b>				
Deposits	\$2,108,450	\$—	\$2,108,250	\$—
Short-Term Borrowings	36,732	—	36,322	—
Subordinated Notes Payable	62,887	—	62,891	—
Long-Term Borrowings	33,282	—	34,715	—

(Dollars in Thousands)	December 31, 2013			
	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
<b>ASSETS:</b>				
Cash	\$55,209	\$55,209	\$—	\$—
Short-Term Investments	474,719	474,719	—	—
Investment Securities, Available for Sale	251,420	71,833	179,587	—
Investment Securities, Held to Maturity	148,211	43,579	103,382	—
Loans Held for Sale	11,065	—	11,065	—
Loans, Net of Allowance for Loan Losses	1,365,509	—	—	1,265,827
<b>LIABILITIES:</b>				
Deposits	\$2,136,248	\$—	\$2,136,737	\$—
Short-Term Borrowings	51,321	—	50,754	—
Subordinated Notes Payable	62,887	—	62,886	—
Long-Term Borrowings	38,043	—	39,450	—

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

**NOTE 10 – OTHER COMPREHENSIVE INCOME (LOSS)**

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

<i>(Dollars in Thousands)</i>	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Three Months Ended June 30, 2014			
Investment Securities:			
Change in net unrealized (gain) loss	\$ 257	\$ (99 )	\$ 158
Amortization of losses on securities transferred from available for sale to held to maturity	16	(6 )	10
Total Other Comprehensive Income	\$ 273	\$ (105 )	\$ 168
Six Months Ended June 30, 2014			
Investment Securities:			
Change in net unrealized (gain) loss	\$ 252	\$ (98 )	\$ 154
Amortization of losses on securities transferred from available for sale to held to maturity	36	(14 )	22
Total Other Comprehensive Loss	\$ 288	\$ (112 )	\$ 176

<i>(Dollars in Thousands)</i>	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Three Months Ended June 30, 2013			
Investment Securities:			
Change in net unrealized (gain) loss	\$(1,615)	\$ 623	\$ (992 )
Reclassification adjustment for impairment loss realized in net income	200	—	200
Total Other Comprehensive Income	\$(1,415)	\$ 623	\$ (792 )
Six Months Ended June 30, 2013			
Investment Securities:			
Change in net unrealized (gain) loss	\$(1,608)	\$ 622	\$ (986 )
Reclassification adjustment for impairment loss realized in net income	200	—	200
Total Other Comprehensive Loss	\$(1,408)	\$ 622	\$ (786 )

Accumulated other comprehensive loss was comprised of the following components:

*(Dollars in Thousands)*

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

	Securities Available for Sale	Retirement Plans	Accumulated Other Comprehensive Loss
Balance as of January 1, 2014	\$ (132 )	\$ (8,408 )	\$ (8,540 )
Other comprehensive income during the period	176	—	176
Balance as of June 30, 2014	\$ 44	\$ (8,408 )	\$ (8,364 )
Balance as of January 1, 2013	\$ 573	\$ (30,132 )	\$ (29,559 )
Other comprehensive loss during the period	(786 )	—	(786 )
Balance as of June 30, 2013	\$ (213 )	\$ (30,132 )	\$ (30,345 )

## NOTE 11 – ACCOUNTING STANDARDS UPDATES

*ASU 2014-01 “Investments – Equity Method and Joint Ventures (Topic 323) – Accounting for Investments in Qualified Affordable Housing Projects.”* ASU 2014-01 provides guidance related to the accounting for investments in qualified affordable housing projects. The guidance allows the holder of low income housing tax credit (“LIHTC”) investments to apply a proportional amortization method that would recognize the cost of the investment as a part of income tax expense, provided that the investment meets certain criteria. The guidance is silent regarding statement of financial position classification, although it would not be appropriate to classify the investment as a deferred tax asset. The decision to apply the proportional amortization method is an accounting policy election. Entities may also elect to continue to account for these investments using the equity method. The guidance will be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted. The Company does not believe this pronouncement will have a significant impact on its financial statements.

*ASU 2014-04 “Receivables – Troubled Debt Restructurings by Creditors (Topic 310-40) – Reclassification of Residential Real Estate Collateralized Consumer Loans Upon Foreclosure.”* ASU 2014-04 provides guidance regarding the reclassification of residential real estate collateralized consumer mortgage loans upon foreclosures. The guidance requires reclassification of a consumer mortgage loan to other real estate owned upon obtaining legal title to the residential property, which could occur either through foreclosure or through a deed in lieu of foreclosure or similar legal agreement. The existence of a borrower redemption right will not prevent the lender from reclassifying a loan to real estate once the lender obtains legal title to the property. In addition, entities are required to disclose the amount of foreclosed residential real estate properties and the recorded investment in residential real estate mortgage loans in the process of foreclosure on both an interim and annual basis. The guidance may be applied prospectively or on a modified retrospective basis in fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. Early adoption is permitted. The Company is in the process of reviewing the potential impact the adoption of this guidance will have to 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 2014 compares with prior years. Throughout this section, Capital City Bank Group, Inc., and subsidiaries, collectively, are referred to as "CCBG," "Company," "we," "us," or "our."

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

### **CAUTION CONCERNING FORWARD-LOOKING STATEMENTS**

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

All forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements. Please see the Introductory Note and *Item 1A. Risk Factors* of our 2013 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 63 full-service offices located in Florida, Georgia, and Alabama. The Bank offers commercial and retail banking services, as well as trust and asset management, retail securities brokerage and data processing services.

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

A detailed discussion regarding the economic conditions in our markets and our long-term strategic objectives is included as part of the MD&A section of our 2013 Form 10-K.

**SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

(Dollars in Thousands, Except Per Share Data)	2014		2013			2012	
	Second	First	Fourth	Third	Second	First	Fourth
Summary of Operations:							
Interest Income	\$ 19,348	\$ 19,236	\$ 20,076	\$ 20,250	\$ 20,698	\$ 21,128	\$ 21,787
Interest Expense	910	950	1,080	1,050	1,103	1,183	1,232
Net Interest Income	18,438	18,286	18,996	19,200	19,595	19,945	20,555
Provision for Loan Losses	499	359	397	555	1,450	1,070	2,766
Net Interest Income After Provision for Loan Losses	17,939	17,927	18,599	18,645	18,145	18,875	17,789
Noninterest Income	13,347	12,785	13,825	14,026	13,731	13,528	13,915
Noninterest Expense	29,076	28,366	29,647	30,153	30,464	31,140	29,265
Income Before Income Taxes	2,210	2,346	2,777	2,518	1,412	1,263	2,439
Income Tax Expense (Benefit)	737	(1,405 )	5	927	569	424	564
Net Income	\$ 1,473	\$ 3,751	\$ 2,772	\$ 1,591	\$ 843	\$ 839	\$ 1,875
Net Interest Income (FTE)	\$ 18,567	\$ 18,424	\$ 19,141	\$ 19,355	\$ 19,744	\$ 20,079	\$ 20,697
Per Common Share:							
Net Income Basic	\$0.08	\$0.22	\$0.16	\$0.09	\$0.05	\$0.05	\$0.11
Net Income Diluted	0.08	0.22	0.16	0.09	0.05	0.05	0.11
Dividends Declared	0.02	0.02	0.00	0.00	0.00	0.00	0.00
Diluted Book Value	16.08	16.02	15.85	14.44	14.36	14.35	14.31
Market Price:							
High	14.71	14.59	12.69	13.08	12.64	12.54	11.91
Low	12.60	11.56	11.33	11.06	10.12	10.95	9.04
Close	14.53	13.28	11.77	11.78	11.53	12.35	11.37
Selected Average Balances:							
Loans, Net	\$ 1,411,988	\$ 1,395,506	\$ 1,414,909	\$ 1,436,039	\$ 1,456,904	\$ 1,496,432	\$ 1,518,280
Earning Assets	2,260,885	2,268,320	2,206,286	2,201,390	2,206,694	2,240,889	2,178,946
Total Assets	2,578,993	2,598,307	2,553,653	2,558,395	2,564,528	2,598,680	2,534,011
Deposits	2,109,563	2,124,960	2,050,870	2,059,498	2,067,647	2,102,967	2,051,099
Shareowners' Equity	282,346	279,729	253,999	251,617	250,485	249,557	253,017
Common Equivalent Average Shares:							
Basic	17,427	17,399	17,341	17,336	17,319	17,302	17,229
Diluted	17,488	17,439	17,423	17,396	17,355	17,309	17,256

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

Performance Ratios:

Return on Average Assets	0.23	%	0.59	%	0.43	%	0.25	%	0.13	%	0.13	%	0.29	%
Return on Average Equity	2.09		5.44		4.33		2.51		1.35		1.36		2.95	
Net Interest Margin (FTE)	3.29		3.29		3.45		3.49		3.59		3.64		3.78	
Noninterest Income as % of Operating Revenue	42.31		42.05		43.85		42.82		41.68		40.62		40.81	
Efficiency Ratio	91.15		91.02		90.22		90.42		91.07		92.67		84.68	

Asset Quality:

Allowance for Loan Losses	\$20,543		\$22,110		23,095		\$25,010		\$27,294		\$27,803		\$29,167	
Allowance for Loan Losses to Loans	1.45	%	1.57	%	1.65	%	1.75	%	1.89	%	1.90	%	1.93	%
Nonperforming Assets ("NPAs")	68,249		78,594		85,035		94,700		96,653		103,869		117,648	
NPAs to Total Assets	2.66		2.98		3.26		3.77		3.77		3.99		4.47	
NPAs to Loans + OREO	4.67		5.42		5.87		6.38		6.44		6.81		7.47	
Allowance to Non-Performing Loans	80.03		63.98		62.48		60.00		65.66		61.17		45.42	
Net Charge-Offs to Average Loans	0.59		0.39		0.65		0.78		0.54		0.66		1.00	

Capital Ratios:

Tier 1 Capital Ratio	16.85	%	16.85	%	16.56	%	15.60	%	15.36	%	14.95	%	14.35	%
Total Capital Ratio	18.10		18.22		17.94		16.97		16.73		16.32		15.72	
Tangible Capital Ratio	7.93		7.66		7.58		6.84		6.64		6.49		6.35	
Leverage Ratio	10.70		10.47		10.46		10.16		10.07		9.81		9.90	

## FINANCIAL OVERVIEW

A summary overview of our financial performance is provided below.

### Results of Operations

Net income of \$1.5 million, or \$0.08 per diluted share, for the second quarter of 2014 compared to net income of \$3.8 million, or \$0.22 per diluted share, in the first quarter of 2014, and net income of \$0.8 million, or \$0.05 per diluted share for the second quarter of 2013. For the six month period ended June 30, 2014, we realized net income of \$5.2 million, or \$0.30 per diluted share, compared to net income of \$1.7 million, or \$0.10 per diluted share, for the comparable period of 2013. First quarter 2014 earnings were favorably impacted by a tax benefit of \$2.2 million, or \$0.13 per share related to an adjustment to our reserve for uncertain tax positions.

Total credit costs (loan loss provision plus other real estate owned (“OREO”) expenses) were \$2.8 million, \$1.8 million, and \$3.7 million for the quarters ended June 30, 2014, March 31, 2014, and March 31, 2013, respectively. Total credit costs for the six month period of 2014 were \$4.5 million compared to \$7.6 million for the same period of 2013. Slower problem loan migration, lower loan losses and improved credit metrics have resulted in a lower loan loss provision. Continued progress in disposing of OREO properties and firming of property values has favorably impacted our level of OREO costs.

Tax equivalent net interest income for the second quarter of 2014 was \$18.6 million compared to \$18.4 million for the first quarter of 2014 and \$19.7 million for the second quarter of 2013. For the first six months of 2014, tax equivalent net interest income totaled \$37.0 million compared to \$39.8 million in 2013. The increase in tax equivalent net interest income compared to the first quarter of 2014 was driven by one additional calendar day, a positive shift in earning asset mix due to growth in the investment and loan portfolios, and a reduction in interest expense. Compared to both prior year periods, the decrease reflects lower loan income primarily attributable to declining loan balances and unfavorable asset repricing that was partially offset by a reduction in interest expense and a lower level of foregone interest on loans.

Noninterest income for the second quarter of 2014 totaled \$13.3 million, an increase of \$0.6 million, or 4.4%, over the first quarter of 2014 and a decrease of \$0.4 million, or 2.8%, from the second quarter of 2013. The increase over the first quarter of 2014 was driven by higher deposit fees and other income. The decrease from the second quarter of 2013 reflects lower data processing fees and mortgage banking fees. For the first six months of 2014, noninterest income totaled \$26.1 million, a \$1.1 million, or 4.1% decrease from the same period of 2013 due to lower deposit fees, mortgage banking fees, and data processing fees.

Noninterest expense for the second quarter of 2014 totaled \$29.1 million, an increase of \$0.7 million, or 2.5%, over the first quarter of 2014 and a decrease of \$1.4 million, or 4.6%, from the second quarter of 2013. The increase over the first quarter of 2014 was primarily attributable to higher OREO expenses. Compared to the second quarter of

2013, the decrease was due to lower compensation expense, reflective of lower expense for our pension plan. For the first six months of 2014, noninterest expense totaled \$57.4 million, a decrease of \$4.1 million, or 6.8%, from the same period of 2013 primarily attributable to lower compensation expense (primarily pension), OREO expense, and other expense (primarily FDIC fees).

## Financial Condition

- Average earning assets were \$2.261 billion for the second quarter of 2014, a decrease of \$7.4 million, or 0.3%, from the first quarter of 2014, and an increase of \$54.6 million, or 2.5%, over the fourth quarter of 2013. The change in earning assets from the first quarter of 2014 reflects a lower level of public fund deposits. The increase compared to the fourth quarter of 2013 reflects a higher level of investments, which was funded through growth in deposits.
- Average loans increased by \$16.5 million, or 1.2%, over the first quarter of 2014, which represents the first quarter-over-quarter increase since 2009. Loan balances increased in most categories with the largest increase in the consumer portfolio. Average loans declined by \$3.0 million, or 0.2% when compared to the fourth quarter of 2013, primarily attributable to lower commercial real estate balances that was partially offset by growth in the consumer loan portfolio.
- Nonperforming assets totaled \$68.2 million at the end of the second quarter of 2014, a decrease of \$10.3 million from the first quarter of 2014 and \$16.8 million from the fourth quarter of 2013. Nonperforming assets represented 2.66% of total assets at June 30, 2014 compared to 2.98% at March 31, 2014 and 3.26% at December 31, 2013.
- As of June 30, 2014, we are well-capitalized with a total risk-based capital ratio of 18.10% and a tangible common equity ratio of 7.93% compared to 18.10% and 7.66%, respectively, at March 31, 2014, and 17.94% and 7.58%, respectively, at December 31, 2013.

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

For the second quarter of 2014, we realized net income of \$1.5 million, or \$0.08 per diluted share, compared to net income of \$3.8 million, or \$0.22 per diluted share for the first quarter of 2014, and net income of \$0.8 million, or \$0.05 per diluted share, for the second quarter of 2013. For the first six months of 2014, we realized net income of \$5.2 million, or \$0.30 per diluted share, compared to net income of \$1.7 million, or \$0.10 per diluted share for the same period of 2013.

Compared to the first quarter of 2014, performance reflects higher noninterest income of \$0.6 million and net interest income of \$0.1 million that was offset by increases in noninterest expense of \$0.7 million, loan loss provision of \$0.2 million, and income taxes of \$2.1 million.

Compared to the second quarter of 2013, the increase in earnings was due to a lower loan loss provision of \$1.0 million and a \$1.4 million decrease in noninterest expense, partially offset by lower net interest income of \$1.1 million, noninterest income of \$0.4 million, and higher income taxes of \$0.2 million.

The increase in earnings for the first six months of 2014 versus the comparable period of 2013 was attributable to lower noninterest expense of \$4.1 million, a lower loan loss provision of \$1.7 million, and lower income taxes of \$1.6 million, partially offset by lower net interest income of \$2.8 million and noninterest income of \$1.1 million.

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

(Dollars in Thousands, except per share data)	Three Months Ended		Six Months Ended		
	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Interest Income	\$19,348	\$19,236	\$20,698	\$38,584	\$41,826
Taxable Equivalent Adjustments	129	138	149	266	283
Total Interest Income (FTE)	19,477	19,374	20,847	38,850	42,109
Interest Expense	910	950	1,103	1,860	2,286
Net Interest Income (FTE)	18,567	18,424	19,744	36,990	39,823
Provision for Loan Losses	499	359	1,450	858	2,520
Taxable Equivalent Adjustments	129	138	149	266	283
Net Interest Income After provision for Loan Losses	17,939	17,927	18,145	35,866	37,020

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

Noninterest Income	13,347	12,785	13,731	26,132	27,260
Noninterest Expense	29,076	28,366	30,464	57,442	61,605
Income Before Income Taxes	2,210	2,346	1,412	4,556	2,675
Income Tax Expense (Benefit)	737	(1,405 )	569	(668 )	993
Net Income	\$1,473	\$3,751	\$843	\$5,224	\$1,682
Basic Net Income Per Share	\$0.08	\$0.22	\$0.05	\$0.30	\$0.10
Diluted Net Income Per Share	\$0.08	\$0.22	\$0.05	\$0.30	\$0.10

## Net Interest Income

Net interest income represents our single largest source of earnings and is equal to interest income and fees generated by earning assets less interest expense paid on interest bearing liabilities. This information is provided on a “taxable equivalent” basis to reflect the tax-exempt status of income earned on certain loans and investments, the majority of which are state and local government debt obligations. We provide an analysis of our net interest income including average yields and rates in Table I on page 44.

Tax equivalent net interest income for the second quarter of 2014 was \$18.6 million compared to \$18.4 million for the first quarter of 2014 and \$19.7 million for the second quarter of 2013. For the six months ended June 30, 2014, tax equivalent net interest income totaled \$37.0 million compared to \$39.8 million for the same period of 2013. The increase in tax equivalent net interest income compared to the first quarter of 2014 reflects one additional calendar day, a positive shift in earning asset mix due to growth in the investment and loan portfolios and a reduction in interest expense, partially offset by unfavorable asset repricing. The lower net interest income when compared to both prior year periods reflects a reduction in loan income primarily attributable to declining loan balances and unfavorable asset repricing, partially offset by a reduction in interest expense and a lower level of foregone interest on loans.

Although the company experienced higher net interest income for the quarter, pressure still remains on net interest income primarily as a result of the low rate environment. The low rate environment remains favorable to the repricing of deposits, but continues to negatively impact the loan and investment portfolios. Increased lending competition in all markets has also unfavorably impacted the pricing for loans.

Although the impact will be minimal, we will continue our efforts to lower our cost of funds, to the extent we can, and shift the mix of our deposits to help mitigate the unfavorable impact of soft loan demand and unfavorable repricing.

The net interest margin for the second quarter of 2014 at 3.29% was equal to the first quarter of 2014 and represented a decline of 30 basis points from the second quarter of 2013. Growth in our investment and loan portfolios helped to maintain our margin from the first to second quarter, while the decrease in the margin from the comparable prior year period was attributable to the shift in our earning asset mix and unfavorable asset repricing, partially offset by a lower average cost of funds.

Historically low interest rates (essentially setting a floor on deposit repricing), foregone interest, unfavorable asset repricing without the flexibility to significantly adjust deposit rates and core deposit growth (which has strengthened our liquidity position, but contributed to an unfavorable shift in our earning asset mix), have all placed pressure on our net interest margin. Our current strategy, which is consistent with our historical strategy, is to not accept greater interest rate risk by reaching further out the curve for yield, particularly given the fact that short term rates are at historical lows. We continue to maintain short duration portfolios on both sides of the balance sheet and believe we are well positioned to respond to changing market conditions. Over time, this strategy has historically produced fairly



consistent outcomes and a net interest margin that is significantly above peer comparisons.

### **Provision for Loan Losses**

The provision for loan losses for the second quarter of 2014 was \$0.5 million compared to \$0.3 million for the first quarter of 2014 and \$1.5 million for the second quarter of 2013. For the first six months of 2014, the loan loss provision totaled \$0.8 million compared to \$2.5 million for the same period of 2013. The lower level of provision reflects continued favorable problem loan migration and improvement in key credit metrics. Net charge-offs for the second quarter of 2014 totaled \$2.1 million, or 0.59% (annualized), of average loans compared to \$1.3 million, or 0.39% (annualized), for the first quarter of 2014 and \$2.0 million, or 0.54% (annualized), for the second quarter of 2013. For the first six months of 2014, net charge-offs totaled \$3.4 million, or 0.49% (annualized), of average loans compared to \$4.4 million, or 0.60%, for the same period of 2013. At quarter-end, the allowance for loan losses of \$20.5 million was 1.45% of outstanding loans (net of overdrafts) and provided coverage of 80% of nonperforming loans compared to 1.57% and 64%, respectively, at March 31, 2014 and 1.65% and 62%, respectively, at December 31, 2013.

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

(Dollars in Thousands, except per share data)	Three Months Ended		Six Months Ended		
	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	June 30, 2013
<b>CHARGE-OFFS</b>					
Commercial, Financial and Agricultural	\$86	\$11	\$119	\$97	\$273
Real Estate - Construction	—	—	110	—	720
Real Estate - Commercial Mortgage	1,029	594	1,050	1,623	2,093
Real Estate - Residential	695	731	1,053	1,426	1,736
Real Estate - Home Equity	375	403	322	778	435
Consumer	421	405	351	826	647
Total Charge-offs	\$2,606	\$2,144	\$3,005	\$4,750	\$5,904
<b>RECOVERIES</b>					
Commercial, Financial and Agricultural	\$45	\$75	\$38	\$120	\$89
Real Estate - Construction	1	4	—	5	—
Real Estate - Commercial Mortgage	152	27	144	179	182
Real Estate - Residential	52	395	396	447	492
Real Estate - Home Equity	65	11	224	76	242
Consumer	225	288	244	513	506
Total Recoveries	\$540	\$800	\$1,046	\$1,340	\$1,511
Net Charge-offs	\$2,066	\$1,344	\$1,959	\$3,410	\$4,393
Net Charge-offs (Annualized) as a percent of Average Loans Outstanding, Net of Unearned Income	0.59 %	0.39 %	0.54 %	0.49 %	0.60 %

### Noninterest Income

Noninterest income for the second quarter of 2014 totaled \$13.3 million, an increase of \$0.6 million, or 4.4%, over the first quarter of 2014 and a decrease of \$0.4 million, or 2.8%, from the second quarter of 2013. The increase over the first quarter of 2014 reflects higher deposit fees of \$0.3 million, bank card fees of \$0.1 million, mortgage banking fees of \$0.1 million, and other income of \$0.2 million, partially offset by lower wealth management fees of \$0.1 million. Compared to the second quarter of 2013, the decrease was primarily due to decreases in data processing fees of \$0.3 million and mortgage banking fees of \$0.2 million that were partially offset by higher other income of \$0.1 million. For the first six months of 2014, noninterest income totaled \$26.1 million, a \$1.1 million, or 4.1% decrease from the same period of 2013 reflective of lower deposit fees of \$0.3 million, mortgage banking fees of \$0.6 million, and data processing fees of \$0.4 million, partially offset by higher bank card fees of \$0.1 million and other income of \$0.1 million.

Noninterest income represented 42.3% of operating revenues (net interest income plus noninterest income) in the second quarter of 2014 compared to 42.0% in the first quarter of 2014 and 41.7% in the second quarter of 2013. For the first six months of 2014, noninterest income represented 42.2% of operating revenues compared to 41.2% for the same period of 2013. The increase in this metric compared to both prior year periods reflects a reduction in net interest income.

The table below reflects the major components of noninterest income.

(Dollars in Thousands)	Three Months Ended		Six Months Ended		
	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Deposit Fees	\$6,213	\$5,869	\$6,217	\$12,082	\$12,382
Bank Card Fees	2,820	2,707	2,754	5,527	5,415
Wealth Management Fees	1,852	1,918	1,901	3,770	3,816
Mortgage Banking Fees	738	625	968	1,363	2,011
Data Processing Fees	388	541	670	929	1,323
Other	1,336	1,125	1,221	2,461	2,313
<b>Total Noninterest Income</b>	<b>\$13,347</b>	<b>\$12,785</b>	<b>\$13,731</b>	<b>\$26,132</b>	<b>\$27,260</b>

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

*Deposit Fees.* Deposit fees for the second quarter of 2014 totaled \$6.2 million, an increase of \$344,000, or 5.9%, over the first quarter of 2014 and comparable to the second quarter of 2013. For the first six months of 2014, deposit fees totaled \$12.1 million, a decrease of \$300,000, or 2.4%, from the comparable period of 2013. The increase over the first quarter of 2014 was attributable to a higher level of overdraft fees and account maintenance fees. Compared to the first six months of 2013, the decrease was due to a lower level of overdraft fees generally reflective of improved financial management by our clients.

*Bank Card Fees.* Bank card fees (including interchange fees and ATM/debit card fees) totaled \$2.8 million for the second quarter of 2014, an increase of \$113,000, or 4.2%, over the first quarter of 2014 and \$66,000, or 2.4%, over the second quarter of 2013. For the first six months of 2014, bank card fees totaled \$5.5 million, which represented an increase of \$112,000, or 2.1%, over the same period of 2013. The increase compared to all prior periods reflects higher card spend by our clients.

*Wealth Management Fees.* Wealth management fees, which include both trust fees (i.e., managed accounts, trusts/estates, and retirement plans) and retail brokerage fees (i.e., investment and insurance products) totaled \$1.9 million for the second quarter of 2014, down slightly by \$66,000, or 3.4%, from the first quarter of 2014 and \$49,000, or 2.6%, from the second quarter of 2013. For the first six months of 2014, wealth management fees totaled \$3.8 million, a slight decrease of \$46,000, or 1.2%, from the same period of 2013. The decrease from all prior periods was primarily due to lower retail brokerage fees reflective of lower account activity of our clients. At June 30, 2014, total assets under management were approximately \$1.270 billion compared to \$1.259 billion at December 31, 2013 and \$1.189 billion at June 30, 2013.

*Mortgage Banking Fees.* Mortgage banking fees totaled \$0.7 million for the second quarter of 2014, an increase of \$113,000, or 18.1%, over the first quarter of 2014 and a decrease of \$230,000, or 23.8%, from the second quarter of 2013. For the first six months of 2014, fees totaled \$1.4 million, a decrease of \$648,000, or 32.2%, from the same period of 2013. Increased new loan production reflective of a seasonal pickup in home purchase activity as well as a higher margin on sold loans drove the increase in fees over the first quarter of 2014. Compared to both prior year periods, the reduction in fees was attributable to lower refinancing activity reflective of a higher rate environment.

*Data Processing Fees.* Data processing fees decreased by \$153,000, or 28.3%, from the first quarter of 2014 and \$282,000, or 42.1%, from the second quarter of 2013. For the first six months of 2014, fees declined by \$394,000, or 29.8%, compared to the first six months of 2013. The decrease from all prior periods was attributable to lower fees from a government processing contract for which processing activity has gradually declined over the past year due to the client's phased migration to a new processor which was finalized in the second quarter of 2014.

*Other.* Other income totaled \$1.3 million for the second quarter of 2014, an increase of \$211,000, or 18.8%, over the first quarter of 2014 and \$115,000, or 9.4%, over the second quarter of 2013. For the first six months of 2014, other income increased \$148,000, or 6.4%, compared to the first six months of 2013. The increase compared to all prior periods was primarily attributable to a higher level of miscellaneous recoveries.

**Noninterest Expense**

Noninterest expense for the second quarter of 2014 totaled \$29.1 million, an increase of \$0.7 million, or 2.5%, over the first quarter of 2014 reflective of higher OREO expense of \$0.9 million, occupancy expense of \$0.2 million, and other expense (excluding OREO expense) of \$0.2 million, partially offset by lower compensation expense of \$0.6 million. Excluding OREO expense, noninterest expense declined \$0.2 million. Compared to the second quarter of 2013, noninterest expense decreased by \$1.4 million, or 4.6%, attributable to lower compensation expense of \$1.4 million (reflecting lower pension expense), and other expense of \$0.3 million, partially offset by higher occupancy expense of \$0.3 million. For the first six months of 2014, noninterest expense totaled \$57.4 million, a decrease of \$4.1 million, or 6.8%, from the same period of 2013 attributable to lower compensation expense of \$2.4 million (primarily pension expense), OREO expense of \$1.4 million, and other expense (excluding OREO expense) of \$0.5 million (primarily FDIC fees), partially offset by higher occupancy expense of \$0.2 million. 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.

(Dollars in Thousands)	Three Months Ended			Six Months Ended	
	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Salaries	\$11,995	\$12,531	\$11,999	\$24,486	\$24,345
Associate Benefits	3,251	3,250	4,648	6,501	9,041
Total Compensation	15,206	15,781	16,647	30,987	33,386
Premises	2,109	2,132	2,149	4,241	4,414
Equipment	2,396	2,166	2,012	4,562	4,165
Total Occupancy	4,505	4,298	4,161	8,803	8,579
Legal Fees	1,037	781	918	1,818	1,918
Professional Fees	963	1,066	1,046	2,029	2,183
Processing Services	1,482	1,472	1,307	2,955	2,434
Advertising	371	318	493	688	815
Travel and Entertainment	270	173	212	442	406
Printing and Supplies	223	274	257	496	507
Telephone	467	480	466	947	957
Postage	307	305	326	612	640
Insurance - Other	731	731	1,040	1,462	2,080
Intangible Amortization	—	32	48	32	116
Other Real Estate Owned	2,276	1,399	2,290	3,675	5,115
Miscellaneous	1,238	1,256	1,253	2,496	2,469
Total Other	9,365	8,287	9,656	17,652	19,640
Total Noninterest Expense	\$29,076	\$28,366	\$30,464	\$57,442	\$61,605

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

*Compensation.* Compensation expense totaled \$15.2 million for the second quarter of 2014, a decrease of \$576,000, or 3.6%, from the first quarter of 2014 due to lower salary expense attributable to lower performance compensation (cash incentives), payroll taxes, and unemployment taxes. Compared to the second quarter of 2013, total compensation expense decreased \$1.4 million, or 8.7%, attributable to lower associate benefit expense driven by lower pension plan expense. The decline was due to the utilization of a higher discount rate in 2014 for determining pension plan liabilities reflecting an increase in long-term bond interest rates. For the first six months of 2014, compensation expense totaled \$31.0 million, a decrease of \$2.4 million, or 7.2%, from the same period of 2013 driven by a \$2.5 million decrease in associate benefit expense, partially offset by lower salary expense of \$141,000. The decrease in associate benefit expense reflects the aforementioned decrease in the expense for our pension plan, and the increase in salary expense was attributable to higher performance compensation (cash incentives).

*Occupancy.* Occupancy expense (including premises and equipment) totaled \$4.5 million for the second quarter of 2014, an increase of \$207,000, or 4.8%, over the first quarter of 2014 driven by higher equipment expense, partially attributable to maintenance costs that were mostly non-routine in nature. Compared to the second quarter of 2013, occupancy expense increased \$344,000, or 8.3%, attributable to higher equipment expense, primarily maintenance costs. For the first six months of 2014, occupancy expense totaled \$8.8 million, a \$224,000, or 2.6%, increase over the same period of 2013 driven by higher equipment expense. The increase in equipment expense compared to both prior year periods reflects higher maintenance cost related to non-routine maintenance activities as well as new maintenance contract expense for physical security upgrades.

*Other.* Other noninterest expense increased \$1.1 million, or 13.0%, over the first quarter of 2014 and decreased \$291,000, or 3.0%, from the second quarter of 2013. The increase compared to the first quarter of 2014 was driven by higher OREO expense of \$877,000 reflective of a higher level of net losses from the sale of bank owned properties. Higher legal fees of \$256,000 also contributed to the variance in other expense and reflect increased legal support needed for problem asset resolutions during the quarter. Compared to the second quarter of 2013, other expense decreased primarily due to lower FDIC insurance expense reflective of a reduction in our premium. For the first six months of 2014, other expense declined \$2.0 million, or 10.1%, over the same period of 2013, primarily attributable to lower OREO expense and FDIC insurance expense, partially offset by higher processing service fees. Reduction in legal fees, professional fees, and advertising fees also contributed to the decline, but to a lesser extent. The reduction in OREO expense primarily reflected a lower level of property valuation adjustments and to a lesser extent lower property carrying costs and net losses on sale of properties. A lower FDIC premium drove the decline in FDIC insurance expense. The higher level of processing service fees reflected the outsourcing of our items processing system during the first quarter of 2013. While increasing the level of expense for processing services, our decision to outsource our items processing system enabled us to reduce expense in other areas such as compensation, printing/supplies, and postage.

Our operating efficiency ratio (expressed as noninterest expense as a percent of the sum of taxable-equivalent net interest income plus noninterest income) was 91.15% for the second quarter of 2014 compared to 91.02% for the first quarter of 2014 and 91.07% for the second quarter of 2013. For the first six months of 2014, this ratio was 91.09% compared to 91.87% for the comparable period of 2013.

## **Income Taxes**

We realized income tax expense of \$0.7 million for the second quarter of 2014 compared to an income tax benefit of \$1.4 million for the first quarter of 2014 and income tax expense of \$0.6 million for the second quarter of 2013. For the first six months of 2014, we realized an income tax benefit of \$0.6 million compared to income tax expense of \$1.0 million for the same period of 2013. Income taxes for both the three and six-month periods of 2014 were favorably impacted by a \$2.2 million state tax benefit attributable to an adjustment in our reserve for uncertain tax positions associated with prior year matters.

## **FINANCIAL CONDITION**



Average assets totaled approximately \$2.579 billion for the second quarter of 2014, a decrease of \$19.3 million, or 0.7%, from the first quarter of 2014, and an increase of \$25.3 million, or 1.0%, from the fourth quarter of 2013. Average earning assets were \$2.261 billion for the second quarter of 2014, a decrease of \$7.4 million, or 0.3%, from the first quarter of 2014, and an increase of \$54.6 million, or 2.5%, over the fourth quarter of 2013. The change in earning assets from the first quarter of 2014 reflected a lower level of public fund deposits and problem loan resolution. The increase compared to the fourth quarter of 2013 reflects a higher level of investments and loans, which was funded through growth in deposits.

### **Investment Securities**

In the second quarter of 2014, our average investment portfolio increased \$34.7 million, or 8.6%, from the first quarter of 2014 and increased \$60.4 million, or 15.9%, from the fourth quarter of 2013. As a percentage of average earning assets, the investment portfolio represented 19.5% in the second quarter of 2014, compared to 17.9% in the prior quarter and 17.2% in the fourth quarter of 2013. The increase in the average balance of the investment portfolio compared to the prior periods was primarily attributable to increases in U.S. Treasury purchases, partially offset by declines in municipal securities. The supply of high quality municipal bonds with attractive spreads over U.S. Treasuries has been limited in the first half of the year. For the remainder of 2014, we will continue to closely monitor liquidity levels and pledging requirements to assess the need to purchase additional investments, as well as look for new investment products that are prudent relative to our risk profile and the Bank's overall investment strategy.

The investment portfolio is a significant component of our operations and, as such, it functions as a key element of liquidity and asset/liability management. Two types of classifications are approved for investment securities which are Available-for-Sale ("AFS") and Held-for-Maturity ("HTM"). During the second quarter of 2014, securities were primarily purchased under the AFS designation. As of June 30, 2014, \$266.3 million, or 59.6% of the investment portfolio was classified as AFS, with the remaining \$180.3 million classified as HTM.

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

At June 30, 2014, the investment portfolio had a net pre-tax unrealized gain in the AFS portfolio of \$0.5 million compared to an unrealized gain of \$0.3 million at both the March 31, 2014 and December 31, 2013 periods. At quarter end, there were approximately 106 positions (combined AFS and HTM) with unrealized losses totaling approximately \$0.7 million. Of the 106 positions, 82 were Ginnie Mae mortgage-backed securities (GNMA), U.S. Treasuries, or SBA securities, all of which carry the full faith and credit guarantee of the U.S. Government. SBA securities float monthly or quarterly to the prime rate and are uncapped. There were 15 SBA positions in an unrealized loss position for longer than 12 months, and have an unrealized loss of \$98,000. There were 19 municipal bonds in an unrealized loss position that were pre-refunded, or rated "AA-" or better. Three of these positions were in an unrealized loss position for longer than 12 months, and had an unrealized loss of \$8,000. The remaining five securities are Federal Farm Credit or Federal Home Loan Bank agency bonds, none of which have been in an unrealized loss position for longer than 12 months. All positions with unrealized losses are not considered impaired, and are expected to mature at par or better.

The average maturity of the total portfolio at June 30, 2014 was 2.16 years compared to 2.08 years and 1.95 years for the March 31, 2014 and December 31, 2013 periods, respectively. The average life of the total portfolio in the second quarter of 2014 extended compared to both prior periods as U.S. Treasury securities with maturities up to three and one-half years were added during the quarter.

## **Loans**

Average loans increased by \$16.5 million, or 1.2%, over the first quarter of 2014, which represents the first quarter-over-quarter increase in average loans since 2009. The improvement in loans was experienced primarily in the consumer and commercial portfolios. The growth was a result of both an increase in production (which has increased in five of the last six quarters) as well as lower payoffs. Average loans declined by \$3.0 million, or 0.2% when compared to the fourth quarter of 2013, primarily attributable to lower commercial real estate, which was partially offset by growth in the consumer loan portfolio.

The resolution of problem loans, which includes loan charge-offs and loans transferred to OREO, totaled \$10.6 million for the second quarter of 2014, compared to \$3.4 million from the first quarter of 2014, and \$6.3 million from the fourth quarter. The problem loan resolutions are based on "as of" balances, not averages.

Without compromising our credit standards or taking on inordinate interest rate risk, we have modified several lending programs in our business, commercial real estate, and consumer portfolios to try to mitigate the significant impact that consumer and business deleveraging is having on our portfolio. These programs have helped to increase overall production.

**Nonperforming Assets**

Nonperforming assets (nonaccrual loans and other real estate owned “OREO”) totaled \$68.2 million at the end of the second quarter of 2014, a decrease of \$10.3 million from the first quarter of 2014 and \$16.8 million from the fourth quarter of 2013. Nonaccrual loans totaled \$25.7 million at the end of the second quarter of 2014, a decrease of \$8.9 million from the first quarter of 2014 and \$11.3 million from the fourth quarter of 2013. Nonaccrual loan additions totaled \$4.4 million in the second quarter of 2014 and \$11.9 million for the first six months of 2014, which compares to \$18.5 million for the same period of 2013. The balance of OREO totaled \$42.6 million at the end of the second quarter of 2014, representing decreases of \$1.5 million from the first quarter of 2014 and \$5.5 million from the fourth quarter of 2013. For the second quarter of 2014, we added properties totaling \$8.0 million, sold properties totaling \$8.6 million, and recorded valuation adjustments totaling \$0.8 million. For the first six months of 2014, we added properties totaling \$9.3 million, sold properties totaling \$13.2 million, and recorded valuation adjustments totaling \$1.6 million. Nonperforming assets represented 2.66% of total assets at June 30, 2014 compared to 2.98% at March 31, 2014 and 3.26% at December 31, 2013.

(Dollars in Thousands)	June 30, 2014	March 31, 2014	December 31, 2013	
Nonaccruing Loans:				
Commercial, Financial and Agricultural	\$ 187	\$ 151	\$ 188	
Real Estate - Construction	847	581	426	
Real Estate - Commercial Mortgage	14,089	23,013	25,227	
Real Estate - Residential	7,267	6,892	6,440	
Real Estate - Home Equity	2,784	3,373	4,084	
Consumer	496	548	599	
Total Nonperforming Loans (“NPLs” <sup>(1)</sup> )	\$ 25,670	\$ 34,558	\$ 36,964	
Other Real Estate Owned	42,579	44,036	48,071	
Total Nonperforming Assets (“NPAs”)	\$ 68,249	\$ 78,594	\$ 85,035	
Past Due Loans 30 – 89 Days	\$ 5,092	\$ 4,902	\$ 7,746	
Past Due Loans 90 Days or More (accruing)	—	—	—	
Performing Troubled Debt Restructurings	\$ 45,440	\$ 46,249	\$ 44,764	
Nonperforming Loans/Loans	1.81	% 2.46	% 2.64	%
Nonperforming Assets/Total Assets	2.66	2.98	3.26	
Nonperforming Assets/Loans Plus OREO	4.67	5.42	5.87	
Allowance/Nonperforming Loans	80.03	% 63.98	% 62.48	%

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

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

(Dollars in Thousands)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013

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

NPA Beginning Balance:	\$78,594	\$103,869	\$85,035	\$117,648
Change in Nonaccrual Loans:				
Beginning Balance	34,558	45,448	36,964	64,222
Additions	4,355	10,758	11,854	18,481
Charge-Offs	(2,445 )	(2,947 )	(4,308 )	(5,672 )
Transferred to OREO	(7,040 )	(3,667 )	(8,316 )	(16,564 )
Paid Off/Payments	(2,423 )	(3,375 )	(5,050 )	(6,975 )
Restored to Accrual	(1,335 )	(4,651 )	(5,474 )	(11,926 )
Ending Balance	25,670	41,566	25,670	41,566
Change in OREO:				
Beginning Balance	44,036	58,421	48,071	53,426
Additions	7,977	4,355	9,267	17,334
Valuation Write-downs	(822 )	(1,060 )	(1,552 )	(2,205 )
Sales	(8,612 )	(6,629 )	(13,207 )	(13,369 )
Other	—	—	—	(99 )
Ending Balance	42,579	55,087	42,579	55,087
NPA Net Change	(10,345)	(7,216 )	(16,786)	(20,995 )
NPA Ending Balance	\$68,249	\$96,653	\$68,249	\$96,653

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

(Dollars in Thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
TDR Beginning Balance:	\$52,538	\$61,426	\$55,770	\$57,353
Additions	377	2,125	2,187	7,139
Charge-Offs	(54 )	—	(151 )	—
Paid Off/Payments	(788 )	(1,256 )	(1,301 )	(1,893 )
Removal Due to Change in TDR Status	(22 )	(1,121 )	(22 )	(1,121 )
Defaults	(833 )	(3,272 )	(5,265 )	(3,576 )
TDR Ending Balance	\$51,218	\$57,902	\$51,218	\$57,902

### 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 \$20.5 million at June 30, 2014 compared to \$22.1 million at March 31, 2014 and \$23.1 million at December 31, 2013. The allowance for loan losses was 1.45% of outstanding loans and provided coverage of 80% of nonperforming loans at June 30, 2014 compared to 1.57% and 64%, respectively, at March 31, 2014 and 1.65% and 62%, respectively, at December 31, 2013. The reduction in the allowance from both prior periods was attributable to a lower level of general reserves and to a lesser extent a reduction in impaired loan reserves. The decrease in general reserves reflects slower problem loan migration, lower loan loss experience, as well as continued improvement in credit metrics. The decrease in impaired loan reserves was driven by a lower level of impaired loans reflecting reduced inflow and successful resolutions as well as lower loss content. It is management's opinion that the allowance at June 30, 2014 is adequate to absorb losses inherent in the loan portfolio at quarter-end.

### Deposits

Average total deposits were \$2.110 billion for the second quarter of 2014, a decrease of \$15.4 million, or 0.7%, from the first quarter of 2014 and an increase of \$58.7 million, or 2.9%, over the fourth quarter of 2013. The decrease in

deposits when compared to the first quarter of 2014 resulted primarily from the reduction in the level of public funds and certificates of deposit. When compared to the fourth quarter of 2013, the increase was a result of higher public funds, noninterest-bearing demand and savings accounts, partially offset by lower certificates of deposit and regular NOWs.

Deposit levels remain strong and our mix of deposits continues to improve as higher cost certificates of deposit are replaced with lower rate non-maturity deposits and noninterest-bearing demand accounts. Prudent pricing discipline will continue to be the key to managing our mix of deposits. Therefore, we do not attempt to compete with higher rate paying competitors for deposits.

## MARKET RISK AND INTEREST RATE SENSITIVITY

### Market Risk and Interest Rate Sensitivity

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

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

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

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

Our interest rate risk management goal is to avoid unacceptable variations in net interest income and capital levels due to fluctuations in market rates. Management attempts to achieve this goal by balancing, within policy limits, the



volume of floating-rate liabilities with a similar volume of floating-rate assets, by keeping the average maturity of fixed-rate asset and liability contracts reasonably matched, by maintaining our core deposits as a significant component of our total funding sources, and by adjusting pricing rates to market conditions on a continuing basis.

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

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

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

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

**Changes in Interest Rates +300 bp +200 bp +100 bp -100 bp**

Policy Limit (±)	10.0%	7.5%	5.0%	5.0%
June 30, 2014	9.4%	9.4%	6.5%	-1.9%
March 31, 2014	11.6%	11.0%	7.6%	-1.8%

The Net Interest Income at Risk position was less favorable at the end of the second quarter of 2014, when compared to the prior quarter-end, for all rate scenarios. The unfavorable change from the prior quarter end reflects lower levels of repricing assets, primarily overnight funds, due to a decrease in deposits. All measures of net interest income at risk are within our prescribed policy limits.

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

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

#### Changes in Interest Rates +300 bp +200 bp +100 bp -100 bp

Policy Limit (±)	12.5%	10.0%	7.5%	7.5%
June 30, 2014	1.7%	4.5%	4.5%	-6.2%
March 31, 2014	1.4%	4.4%	4.4%	-6.4%

As of June 30, 2014, the improvement in the economic value of equity in all rate scenarios versus the base case was more favorable than it was as of March 31, 2014. This favorable variance is primarily attributable to the overall change in market interest rates during the second quarter of 2014. In both periods, in the up 300 bp scenario (relative to the up 200 and 100 bp scenarios), the level of improvement in the economic value of equity declined. This is attributable to the varied assumptions on the non-maturity deposits. Based on historical data, interest rates on non-maturity deposits are increased in escalating increments in the rising rate scenarios, with the up 300 bp scenario being the most aggressive. All measures of economic value of equity are within our prescribed policy limits.

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

## LIQUIDITY AND CAPITAL RESOURCES

### Liquidity

In general terms, liquidity is a measurement of our ability to meet our cash needs. Our objective in managing our liquidity is to maintain our ability to meet loan commitments, purchase securities or repay deposits and other liabilities in accordance with their terms, without an adverse impact on our current or future earnings. Our liquidity strategy is guided by policies that are formulated and monitored by our ALCO and senior management, and which take into

account the marketability of assets, the sources and stability of funding and the level of unfunded commitments. We regularly evaluate all of our various funding sources with an emphasis on accessibility, stability, reliability and cost-effectiveness. Our principal source of funding has been our client deposits, supplemented by our short-term and long-term borrowings, primarily from securities sold under repurchase agreements, federal funds purchased and FHLB borrowings. We believe that the cash generated from operations, our borrowing capacity and our access to capital resources are sufficient to meet our future operating capital and funding requirements.

As of June 30, 2014, we have the ability to generate \$889.5 million in additional liquidity through all of our available resources. In addition to primary borrowing outlets mentioned above, we also have the ability to generate liquidity by borrowing from the Federal Reserve Discount Window and through brokered deposits. We recognize the importance of maintaining liquidity and have developed a Contingency Liquidity Plan, which addresses various liquidity stress levels and our response and action based on the level of severity. We periodically test our credit facilities for access to the funds, but also understand that as the severity of the liquidity level increases that certain credit facilities may no longer be available. A liquidity stress test is completed on a quarterly basis based on events that could potentially occur at the Bank with results reported to ALCO, our Market Risk and Oversight Committee, and the Board of Directors. The liquidity available to us is considered sufficient to meet our ongoing needs.

We view our investment portfolio primarily as a source of liquidity and have the option to pledge the portfolio as collateral for borrowings or deposits, and/or sell selected securities. The portfolio consists of debt issued by the U.S. Treasury, U.S. governmental and federal agencies, and municipal governments. The weighted average life of the portfolio is approximately 2.16 years, and as of June 30, 2014 had a net unrealized pre-tax gain of \$0.5 million in the available-for-sale portfolio.

Our average liquidity (defined as funds sold plus interest bearing deposits with other banks less funds purchased) was \$408.7 million during the second quarter of 2014 compared to an average net overnight funds sold position of \$467.3 million in the first quarter of 2014 and an average overnight funds sold position of \$411.6 million in the fourth quarter of 2013. The lower balance when compared to the first quarter of 2014 primarily reflects higher loan and investment portfolios, and the lower level of public funds. The decrease when compared to the fourth quarter of 2013 reflects an increase in the investment portfolio partially offset by a higher level of public funds.

Capital expenditures are estimated to approximate \$3.0 million over the next 12 months, which will consist primarily of office remodeling, office equipment/furniture, and technology purchases. Management believes that these capital expenditures will be funded with existing resources without impairing our ability to meet our on-going obligations.

## **Borrowings**

At June 30, 2014, advances from the FHLB consisted of \$34.5 million in outstanding debt consisting of 35 notes. During the first six months of 2014, the Bank made FHLB advance payments totaling approximately \$7.5 million, which includes paying off six advances totaling \$5.9 million. No additional FHLB advances were obtained. The FHLB notes are collateralized by a blanket floating lien on all of our 1-4 family residential mortgage loans, commercial real estate mortgage loans, and home equity mortgage loans.

We have issued two junior subordinated deferrable interest notes to our wholly-owned Delaware statutory trusts. The first note for \$30.9 million was issued to CCBG Capital Trust I in November 2004. The second note for \$32.0 million was issued to CCBG Capital Trust II in May 2005. The interest payment for the CCBG Capital Trust I borrowing is due quarterly and adjusts quarterly to a variable rate of LIBOR plus a margin of 1.90%. This note matures on December 31, 2034. The interest payment for the CCBG Capital Trust II borrowing is due quarterly and adjusts annually to a variable rate of LIBOR plus a margin of 1.80%. This note matures on June 15, 2035. The proceeds of these borrowings were used to partially fund acquisitions.

Under the terms of each junior subordinated deferrable interest note, in the event of default or if we elect to defer interest on the note, we may not, with certain exceptions, declare or pay dividends or make distributions on our capital stock or purchase or acquire any of our capital stock. During the fourth quarter of 2013, the informal board resolutions, which required us to obtain approval from the Federal Reserve prior to making interest payments on the two securities, were rescinded. All deferred accrued interest was paid and brought current at year-end 2013 and is current as of June 30, 2014.

## **Capital**

Equity capital was \$281.6 million as of June 30, 2014, compared to \$279.9 million as of March 31, 2014 and \$276.4 million as of December 31, 2013. Our leverage ratio was 10.70%, 10.47%, and 10.46%, respectively, and our tangible capital ratio was 7.93%, 7.66%, and 7.58%, respectively, for the same periods. Our risk-adjusted capital ratio of 18.10% at June 30, 2014, exceeds the 10% threshold to be designated as “well-capitalized” under the risk-based regulatory guidelines.

During the first six months of 2014, shareowners' equity increased \$5.2 million, or 3.7%, on an annualized basis. During this same period, shareowners' equity was positively impacted by net income of \$5.2 million, stock compensation accretion of \$0.4 million, a \$0.2 million net increase in the unrealized gain on investment securities, and net adjustments totaling \$0.1 million related to transactions under our stock compensation plans. Shareowners' equity was reduced by common stock dividends totaling \$0.7 million.

At June 30, 2014, our common stock had a book value of \$16.08 per diluted share compared to \$16.02 at March 31, 2014 and \$15.85 at December 31, 2013. Book value is impacted by changes in the amount of our net unrealized gain or loss on investment securities available-for-sale and changes to the amount of our unfunded pension liability both of which are recorded through other comprehensive income. At June 30, 2014, the net unrealized gain on investment securities available for sale was \$44,000 and the amount of our unfunded pension liability was \$8.4 million.

In February 2014, our Board of Directors authorized the repurchase of up to 1,500,000 shares of our outstanding common stock. Repurchases may be made in the open market or in privately negotiated transactions; however, we are not obligated to repurchase any specified number of shares. Under a predecessor plan, we repurchased a total of 2,520,130 shares at an average purchase price of \$25.19 per share. We did not repurchase any shares during 2013 or during the first six months of 2014.

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

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

At June 30, 2014, we had \$312.1 million in commitments to extend credit and \$8.9 million in standby letters of credit. Commitments to extend credit are agreements to lend to a client so long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued by us to guarantee the performance of a client to a third party. We use the same credit policies in establishing commitments and issuing letters of credit as we do for on-balance sheet instruments.

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

## **CRITICAL ACCOUNTING POLICIES**

Our significant accounting policies are described in Note 1 to the Consolidated Financial Statements included in our 2013 Form 10-K. The preparation of our Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States ("GAAP") and reporting practices applicable to the banking industry requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates.

We have identified accounting for (i) the allowance for loan and lease losses, (ii) valuation of goodwill and other intangible assets, and (iii) pension benefits as our most critical accounting policies and estimates in that they are important to the portrayal of our financial condition and results, and they require our subjective and complex judgment as a result of the need to make estimates about the effects of matters that are inherently uncertain. These accounting policies, including the nature of the estimates and types of assumptions used, are described throughout this Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2013 Form 10-K.

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

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014		2013	2014		2013
(Dollars in Thousands)	Average Balances	Average Interest	Average Rate	Average Balances	Average Interest	Average Rate
<b>Assets:</b>						
Loans <sup>(1)(2)</sup>	\$1,411,988	\$18,216	5.17%	\$1,456,904	\$19,790	5.45%
Taxable Securities <sup>(2)</sup>	345,419	816	0.87	225,770	578	1.02
Tax-Exempt Securities	94,810	188	0.77	104,981	200	0.76
Funds Sold	408,668	257	0.25	419,039	279	0.27
Total Earning Assets	2,260,885	19,477	3.46%	2,206,694	20,847	3.79%
Cash & Due From Banks	44,115			49,081		
Allowance For Loan Losses	(22,255 )			(29,012 )		
Other Assets	296,248			337,765		
<b>TOTAL ASSETS</b>	<b>\$2,578,993</b>			<b>\$2,564,528</b>		
<b>Liabilities:</b>						
NOW Accounts	\$724,635	\$91	0.05%	\$716,459	\$124	0.07%
Money Market Accounts	280,619	50	0.07	289,637	54	0.07
Savings Accounts	227,960	28	0.05	202,784	25	0.05
Other Time Deposits	209,558	124	0.24	231,134	164	0.29
Total Interest Bearing Deposits	1,442,772	293	0.08	1,440,014	367	0.10
Short-Term Borrowings	44,473	17	0.15	52,399	61	0.47
Subordinated Note Payable	62,887	331	2.08	62,887	342	2.15
Other Long-Term Borrowings	33,619	269	3.21	40,942	333	3.26
Total Interest Bearing Liabilities	1,583,751	910	0.23%	1,596,242	1,103	0.28%
Noninterest Bearing Deposits	666,791			627,633		
Other Liabilities	46,105			90,168		
<b>TOTAL LIABILITIES</b>	<b>2,296,647</b>			<b>2,314,043</b>		

TOTAL SHAREOWNERS' EQUITY	282,346	250,485	281,045	250,023
TOTAL LIABILITIES AND SHAREOWNERS' EQUITY	\$2,578,993	\$2,564,528	\$2,588,597	\$2,581,5
Interest Rate Spread		3.22%	3.51%	3.23%
Net Interest Income	\$18,567	\$19,744	\$36,991	
Net Interest Margin <sup>(3)</sup>		3.29%	3.59%	3.29%

*Average balances include nonaccrual loans. Interest income periods in this table include loan fees of \$297,000 and (1)\$707,000 for the three and six months ended June 30, 2014 and \$396,000 and \$782,000 for the comparable periods ended June 30, 2013.*

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

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



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

See “Market Risk and Interest Rate Sensitivity” in Management’s Discussion and Analysis of Financial Condition and Results of Operations, above, which is incorporated herein by reference. Management has determined that no additional disclosures are necessary to assess changes in information about market risk that have occurred since December 31, 2013.

**Item 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

As of June 30, 2014, the end of the period covered by this Form 10-Q, our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer each concluded that as of June 30, 2014, the end of the period covered by this Form 10-Q, we maintained effective disclosure controls and procedures.

**Changes in Internal Control over Financial Reporting**

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

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

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

**Item 1A. Risk Factors**

In addition to the other information set forth in this Quarterly Report, you should carefully consider the factors discussed in Part I, Item 1A. “Risk Factors” in our 2013 Form 10-K, as updated in our subsequent quarterly reports. The risks described in our 2013 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**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

(A)

Exhibits

- |      |  |
|------|--|
| 31.1 | Certification of William G. Smith, Jr., Chairman, President and Chief Executive Officer of Capital City Bank Group, Inc., Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.   |
| 31.2 | Certification of J. Kimbrough Davis, Executive Vice President and Chief Financial Officer of Capital City Bank Group, Inc., Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934. |
| 32.1 | Certification of William G. Smith, Jr., Chairman, President and Chief Executive Officer of Capital City Bank Group, Inc., Pursuant to 18 U.S.C. Section 1350.                                  |
| 32.2 | Certification of J. Kimbrough Davis, Executive Vice President and Chief Financial Officer of Capital City Bank Group, Inc., Pursuant to 18 U.S.C. Section 1350.                                |

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

46

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned Chief Financial Officer hereunto duly authorized.

CAPITAL CITY BANK GROUP, INC.

(Registrant)

/s/ J. Kimbrough Davis

J. Kimbrough Davis

Executive Vice President and Chief Financial Officer

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

Date: August 8, 2014

Exhibit Index

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