

COLONY BANKCORP INC
Form 10-Q
August 03, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

FOR QUARTER ENDED JUNE 30, 2015 COMMISSION FILE NUMBER 0-12436

COLONY BANKCORP, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

GEORGIA 58-1492391
(STATE OR OTHER JURISDICTION OF (I.R.S. EMPLOYER

INCORPORATION OR ORGANIZATION) IDENTIFICATION NUMBER)

115 SOUTH GRANT STREET, FITZGERALD, GEORGIA 31750

ADDRESS OF PRINCIPAL EXECUTIVE OFFICES

229/426-6000

REGISTRANT'S TELEPHONE NUMBER INCLUDING AREA CODE

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED REPORTS REQUIRED TO BE FILED BY SECTIONS 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 "ACCELERATED FILER", "LARGE 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 A 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

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER'S CLASSES OF COMMON STOCK, AS OF THE LATEST PRACTICABLE DATE.

<u>CLASS</u>	<u>OUTSTANDING AT AUGUST 3, 2015</u>
COMMON STOCK, \$1 PAR VALUE	8,439,258

TABLE OF CONTENTS

	<u>Page</u>
<u>PART I – Financial Information</u>	
Forward Looking Statement Disclosure	3
Item 1. Financial Statements	5
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	40
Item 3. Quantitative and Qualitative Disclosures About Market Risk	53
Item 4. Controls and Procedures	54
<u>PART II – Other Information</u>	
Item 1. Legal Proceedings	55
Item 1A. Risk Factors	55
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	55
Item 3. Defaults Upon Senior Securities	55
Item 4. (Removed and Reserved)	55
Item 5. Other Information	55
Item 6. Exhibits	56
Signatures	58

Forward Looking Statement Disclosure

Certain statements contained in this Quarterly Report that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the Act), notwithstanding that such statements are not specifically identified. In addition, certain statements may be contained in the Company's future filings with the SEC, in press releases, and in oral and written statements made by or with the approval of the Company that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans and objectives of Colony Bankcorp, Inc. or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes," "anticipates," "expects," "intends," "targeted" and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

Loss and regional economic conditions and the impact they may have on the Company and its customers and the Company's assessment of that impact.

Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.

The effects of and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve Board.

Inflation, interest rate, market and monetary fluctuations.

Political instability.

Acts of war or terrorism.

The timely development and acceptance of new products and services and perceived overall value of these products and services by users.

Changes in consumer spending, borrowings and savings habits.

Technological changes.

Acquisitions and integration of acquired businesses.

The ability to increase market share and control expenses.

The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Company and its subsidiary must comply.

The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters.

Changes in the Company's organization, compensation and benefit plans.

The costs and effects of litigation and of unexpected or adverse outcomes in such litigation.

Greater than expected costs or difficulties related to the integration of new lines of business.

The Company's success at managing the risks involved in the foregoing items.

Forward-looking statements speak only as of the date on which such statements are made. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

Readers should carefully review all disclosures we file from time to time with the Securities and Exchange Commission (SEC).

PART 1. FINANCIAL INFORMATION

ITEM 1

FINANCIAL STATEMENTS

THE FOLLOWING FINANCIAL STATEMENTS ARE PROVIDED FOR COLONY BANKCORP, INC. AND ITS WHOLLY-OWNED SUBSIDIARY BANK, COLONY BANK

- A. CONSOLIDATED BALANCE SHEETS – JUNE 30, 2015 (UNAUDITED) AND DECEMBER 31, 2014 (AUDITED).
- B. CONSOLIDATED STATEMENTS OF INCOME – FOR THE THREE MONTHS ENDED JUNE 30, 2015 AND 2014 AND FOR THE SIX MONTHS ENDED JUNE 30, 2015 AND 2014 (UNAUDITED).
- C. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME – FOR THE THREE MONTHS ENDED JUNE 30, 2015 AND 2014 AND FOR THE SIX MONTHS ENDED JUNE 30, 2015 AND 2014 (UNAUDITED).
- D. CONSOLIDATED STATEMENTS OF CASH FLOWS – FOR THE SIX MONTHS ENDED JUNE 30, 2015 AND 2014 (UNAUDITED).

THE CONSOLIDATED FINANCIAL STATEMENTS FURNISHED HAVE NOT BEEN AUDITED BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS, BUT REFLECT, IN THE OPINION OF MANAGEMENT, ALL ADJUSTMENTS (CONSISTING SOLELY OF NORMAL RECURRING ADJUSTMENTS) NECESSARY FOR A FAIR PRESENTATION OF THE RESULTS OF OPERATIONS FOR THE PERIODS PRESENTED.

THE RESULTS OF OPERATIONS FOR THE SIX MONTH PERIOD ENDED JUNE 30, 2015 ARE NOT NECESSARILY INDICATIVE OF THE RESULTS TO BE EXPECTED FOR THE FULL YEAR.

Part I (Continued)

Item 2 (Continued)

**COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
JUNE 30, 2015 AND DECEMBER 31, 2014
(DOLLARS IN THOUSANDS)**

	June 30, 2015 (Unaudited)	December 31, 2014 (Audited)
ASSETS		
Cash and Cash Equivalents		
Cash and Due from Banks	\$ 19,550	\$24,473
Federal Funds Sold	-	20,132
	19,550	44,605
Interest-Bearing Deposits	24,323	21,206
Investment Securities		
Available for Sale, at Fair Value	273,878	274,594
Held to Maturity, at Cost (Fair Value of \$27 and \$30, as of June 30, 2015 and December 31, 2014, Respectively)	27	30
	273,905	274,624
Federal Home Loan Bank Stock, at Cost	2,731	2,831
Loans		
Allowance for Loan Losses	760,078	746,094
Unearned Interest and Fees	(8,480)	(8,802)
	(388)	(362)
	751,210	736,930
Premises and Equipment	24,465	24,960
Other Real Estate (Net of Allowance of \$3,222 and \$3,320 as of June 30, 2015 and December 31, 2014, Respectively)	12,031	10,402
Other Intangible Assets	134	152
Other Assets	30,701	31,188
Total Assets	\$ 1,139,050	\$ 1,146,898
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-Bearing	\$ 125,541	\$128,340
Interest-Bearing	843,093	850,963
	968,634	979,303
Borrowed Money		
Subordinated Debentures	24,229	24,229
Other Borrowed Money	40,000	40,000

	64,229	64,229
Other Liabilities	3,528	4,339
Stockholders' Equity		
Preferred Stock, Stated Value \$1,000 a Share; Authorized 10,000,000 Shares, Issued 28,000 Shares	28,000	28,000
Common Stock, Par Value \$1 a Share; Authorized 20,000,000 Shares, Issued 8,439,258 Shares as of June 30, 2015 and December 31, 2014	8,439	8,439
Paid-In Capital	29,145	29,145
Retained Earnings	41,097	38,288
Accumulated Other Comprehensive (Loss), Net of Tax Benefits	(4,022)	(4,845)
	102,659	99,027
Total Liabilities and Stockholders' Equity	\$ 1,139,050	\$ 1,146,898

The accompanying notes are an integral part of these statements.

Part I (Continued)

Item 2 (Continued)

**COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED JUNE 30, 2015 AND 2014
AND SIX MONTHS ENDED JUNE 30, 2015 AND 2014
(UNAUDITED)
(DOLLARS IN THOUSANDS)**

	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2015	2014	2015	2014
Interest Income				
Loans, Including Fees	\$9,873	\$9,956	\$19,582	\$19,645
Federal Funds Sold	-	8	15	17
Deposits with Other Banks	24	10	41	23
U.S. Government Agencies	978	1,225	2,048	2,409
State, County and Municipal	25	23	50	51
Dividends on Other Investments	30	29	60	59
	10,930	11,251	21,796	22,204
Interest Expense				
Deposits	1,219	1,288	2,438	2,609
Borrowed Money	464	435	909	873
	1,683	1,723	3,347	3,482
Net Interest Income	9,247	9,528	18,449	18,722
Provision for Loan Losses	129	481	491	808
Net Interest Income After Provision for Loan Losses	9,118	9,047	17,958	17,914
Noninterest Income				
Service Charges on Deposits	1,040	1,087	2,051	2,183
Other Service Charges, Commissions and Fees	664	623	1,302	1,175
Mortgage Fee Income	134	114	247	181
Securities Gains (Losses)	-	1	3	1
Other	520	421	967	768
	2,358	2,246	4,570	4,308
Noninterest Expenses				
Salaries and Employee Benefits	4,407	4,305	8,875	8,717
Occupancy and Equipment	1,017	1,000	2,010	2,020
Other	2,896	2,986	5,721	6,420
	8,320	8,291	16,606	17,157
Income Before Income Taxes	3,156	3,002	5,922	5,065

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Income Taxes	971	986	1,854	1,592
Net Income	2,185	2,016	4,068	3,473
Preferred Stock Dividends	630	681	1,260	1,324
Net Income Available to Common Stockholders	\$1,555	\$1,335	\$2,808	\$2,149
Net Income Per Share of Common Stock				
Basic	\$0.18	\$0.16	\$0.33	\$0.25
Diluted	\$0.18	\$0.16	\$0.33	\$0.25
Cash Dividends Declared Per Share of Common Stock	\$-	\$-	\$-	\$-
Weighted Average Basic Shares Outstanding	8,439,258	8,439,258	8,439,258	8,439,258
Weighted Average Diluted Shares Outstanding	8,441,628	8,439,258	8,440,443	8,439,258

The accompanying notes are an integral part of these statements.

Part I (Continued)

Item 2 (Continued)

COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
THREE MONTHS ENDED JUNE 30, 2015 AND 2014
AND SIX MONTHS ENDED JUNE 30, 2015 AND 2014
(UNAUDITED)
(DOLLARS IN THOUSANDS)

	Three Months Ended		Six Months Ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Net Income	\$2,185	\$2,016	\$4,068	\$3,473
Other Comprehensive Income:				
Gains on Securities Arising During the Year	(1,908)	2,314	1,250	4,708
Tax Effect	649	(787)	(425)	(1,601)
Realized (Losses) on Sale of AFS Securities	-	-	(3)	-
Tax Effect	-	-	1	-
Change in Unrealized Gains (Losses) on Securities	(1,259)	1,527	823	3,107
Available for Sale, Net of Reclassification Adjustment and Tax Effects				
Comprehensive Income	\$926	\$3,543	\$4,891	\$6,580

The accompanying notes are an integral part of these statements.

Part I (Continued)

Item 2 (Continued)

**COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED JUNE 30, 2015 AND 2014
(UNAUDITED)
(DOLLARS IN THOUSANDS)**

	Six Months Ended	
	June 30,	June 30,
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$4,068	\$3,473
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	821	797
Provision for Loan Losses	491	808
Securities (Gains) Losses	(3)	(1)
Amortization and Accretion	931	628
Losses on Sale of Other Real Estate and Repossessions	(71)	509
Provision for Losses on Other Real Estate	18	245
Increase in Cash Surrender Value of Life Insurance	(26)	(325)
Other Prepaids, Deferrals and Accruals, Net	(747)	2,641
	5,482	8,775
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Investment Securities Available for Sale	(51,849)	(25,034)
Proceeds from Maturities, Calls, and Paydowns of Investment Securities:		
Available for Sale	27,751	16,349
Held for Maturity	5	8
Proceeds from Sale of Investment Securities		
Available for Sale	25,173	-
Interest-Bearing Deposits in Other Banks	(3,117)	10,588
Net Loans to Customers	(20,253)	10,863
Purchase of Premises and Equipment	(354)	(871)
Proceeds from Sale of Other Real Estate and Repossessions	3,907	5,008
Proceeds from Sale of Federal Home Loan Bank Stock	100	333
Proceeds from Sale of Fixed Assets	29	3
	(18,608)	17,247
CASH FLOWS FROM FINANCING ACTIVITIES		
Noninterest-Bearing Customer Deposits	(2,799)	(504)
Interest-Bearing Customer Deposits	(7,870)	(38,757)
Dividends Paid for Preferred Stock	(1,260)	-
	(11,929)	(39,261)

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Net Decrease in Cash and Cash Equivalents	(25,055)	(13,239)
Cash and Cash Equivalents at Beginning of Period	44,605	46,187
Cash and Cash Equivalents at End of Period	\$19,550	\$32,948

The accompanying notes are an integral part of these statements.

Part I (Continued)

Item 2 (Continued)

COLONY BANKCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Presentation

Colony Bankcorp, Inc. (the Company) is a bank holding company located in Fitzgerald, Georgia. The consolidated financial statements include the accounts of Colony Bankcorp, Inc. and its wholly-owned subsidiary, Colony Bank, Fitzgerald, Georgia. All significant intercompany accounts have been eliminated in consolidation. The accounting and reporting policies of Colony Bankcorp, Inc. conform to generally accepted accounting principles and practices utilized in the commercial banking industry.

All dollars in notes to consolidated financial statements are rounded to the nearest thousand, except for per share amounts.

The consolidated financial statements in this report are unaudited, except for the December 31, 2014 consolidated balance sheet. All adjustments consisting of normal recurring accruals which are, in the opinion of management, necessary for fair presentation of the interim consolidated financial statements have been included and fairly and accurately present the financial position, results of operations and cash flows of the Company. The results of operations for the six months ended June 30, 2015, are not necessarily indicative of the results which may be expected for the entire year.

Nature of Operations

The Bank provides a full range of retail and commercial banking services for consumers and small- to medium-size businesses located primarily in central, south and coastal Georgia. Colony Bank is headquartered in Fitzgerald,

Georgia with banking offices in Albany, Ashburn, Broxton, Centerville, Chester, Columbus, Cordele, Douglas, Eastman, Fitzgerald, Leesburg, Moultrie, Pitts, Quitman, Rochelle, Savannah, Soperton, Sylvester, Thomaston, Tifton, Valdosta and Warner Robins. Lending and investing activities are funded primarily by deposits gathered through its retail banking office network.

Use of Estimates

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans.

Reclassifications

In certain instances, amounts reported in prior years' consolidated financial statements have been reclassified to conform to statement presentations selected for 2015. Such reclassifications had no effect on previously reported stockholders' equity or net income.

Concentrations of Credit Risk

Concentrations of credit risk can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries, or certain geographic regions. The Company has a concentration in real estate loans as well as a geographic concentration that could pose an adverse credit risk, particularly with the current economic downturn in the real estate market. At June 30, 2015, approximately 86 percent of the Company's loan portfolio was concentrated in loans secured by real estate. A substantial portion of borrowers' ability to honor their contractual obligations is dependent upon the viability of the real estate economic sector. Declining collateral real estate values that secure land development, construction and speculative real estate loans in the Company's larger MSA markets have resulted in high loan loss provisions in recent years. In addition, a large portion of the Company's foreclosed assets are also located in these same geographic markets, making the recovery of the carrying amount of foreclosed assets susceptible to changes in market conditions. Management continues to monitor these concentrations and has considered these concentrations in its allowance for loan loss analysis.

Part I (Continued)

Item 2 (Continued)

(1) Summary of Significant Accounting Policies (Continued)

Concentrations of Credit Risk (Continued)

The success of the Company is dependent, to a certain extent, upon the economic conditions in the geographic markets it serves. Adverse changes in the economic conditions in these geographic markets would likely have a material adverse effect on the Company's results of operations and financial condition. The operating results of Colony depend primarily on its net interest income. Accordingly, operations are subject to risks and uncertainties surrounding the exposure to changes in the interest rate environment.

At times, the Company may have cash and cash equivalents at financial institutions in excess of federal deposit insurance limits. The Company places its cash and cash equivalents with high credit quality financial institutions whose credit ratings are monitored by management to minimize credit risk.

Investment Securities

The Company classifies its investment securities as trading, available for sale or held to maturity. Securities that are held principally for resale in the near term are classified as trading. Trading securities are carried at fair value, with realized and unrealized gains and losses included in noninterest income. Currently, no securities are classified as trading. Securities acquired with both the intent and ability to be held to maturity are classified as held to maturity and reported at amortized cost. All securities not classified as trading or held to maturity are considered available for sale. Securities available for sale are reported at estimated fair value. Unrealized gains and losses on securities available for sale are excluded from earnings and are reported, net of deferred taxes, in accumulated other comprehensive income (loss), a component of stockholders' equity. Gains and losses from sales of securities available for sale are computed using the specific identification method. Securities available for sale includes securities, which may be sold to meet liquidity needs arising from unanticipated deposit and loan fluctuations, changes in regulatory capital requirements, or unforeseen changes in market conditions.

The Company evaluates each held to maturity and available for sale security in a loss position for other-than-temporary impairment (OTTI). In estimating other-than-temporary impairment losses, management

considers such factors as the length of time and the extent to which the market value has been below cost, the financial condition of the issuer and the Company's intent to sell and whether it is more likely than not that the Company will be required to sell the security before anticipated recovery of the amortized cost basis. If the Company intends to sell or if it is more likely than not that the Company will be required to sell the security before recovery, the OTTI write-down is recognized in earnings. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings and an amount related to all other factors, which is recognized in other comprehensive income (loss).

Federal Home Loan Bank Stock

Investment in stock of a Federal Home Loan Bank (FHLB) is required for every federally insured institution that utilizes its services. FHLB stock is considered restricted, as defined in the accounting standards. The FHLB stock is reported in the consolidated financial statements at cost. Dividend income is recognized when earned.

Loans

Loans that the Company has the ability and intent to hold for the foreseeable future or until maturity are recorded at their principal amount outstanding, net of unearned interest and fees. Loan origination fees, net of certain direct origination costs, are deferred and amortized over the estimated terms of the loans using the straight-line method. Interest income on loans is recognized using the effective interest method.

A loan is considered to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date.

When management believes there is sufficient doubt as to the collectibility of principal or interest on any loan or generally when loans are 90 days or more past due, the accrual of applicable interest is discontinued and the loan is designated as nonaccrual, unless the loan is well secured and in the process of collection. Interest payments received on nonaccrual loans are either applied against principal or reported as income, according to management's judgment as to the collectibility of principal. Loans are returned to an accrual status when factors indicating doubtful collectibility on a timely basis no longer exist.

Part I (Continued)

Item 2 (Continued)

(1) Summary of Significant Accounting Policies (Continued)

Loans Modified in a Troubled Debt Restructuring (TDR)

Loans are considered to have been modified in a TDR when, due to a borrower's financial difficulty, the Company makes certain concessions to the borrower that it would not otherwise consider for new debt with similar risk characteristics. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of the collateral. Generally, a non-accrual loan that has been modified in a TDR remains on non-accrual status for a period of 6 months to demonstrate that the borrower is able to meet the terms of the modified loan. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on non-accrual status. Once a loan is modified in a troubled debt restructuring it is accounted for as an impaired loan, regardless of its accrual status, until the loan is paid in full, sold or charged off.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revisions as more information becomes available.

The allowance consists of specific, historical and general components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an

allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The historical component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors. A general component is maintained to cover uncertainties that could affect management's estimate of probable losses. The general component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and historical losses in the portfolio. General valuation allowances are based on internal and external qualitative risk factors such as (i) changes in the composition of the loan portfolio, (ii) the extent of loan concentrations within the portfolio, (iii) the effectiveness of the Company's lending policies, procedures and internal controls, (iv) the experience, ability and effectiveness of the Company's lending management and staff, and (v) national and local economics and business conditions.

Loans identified as losses by management, internal loan review and/or regulatory agencies are charged off.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

A significant portion of the Company's impaired loans are deemed to be collateral dependent. Management therefore measures impairment on these loans based on the fair value of the collateral. Collateral values are determined based on appraisals performed by qualified licensed appraisers hired by the Company or by senior members of the Company's credit administration staff. The decision whether or not to obtain an external third-party appraisal usually depends on the type of property being evaluated. External appraisals are usually obtained on more complex, income producing properties such as hotels, shopping centers and businesses. Less complex properties such as residential lots, farm land and single family houses may be evaluated internally by senior credit administration staff.

Part I (Continued)

Item 2 (Continued)

(1) Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

When the Company does obtain appraisals from external third-parties, the values utilized in the impairment calculation are “as is” or current market values. The appraisals, whether prepared internally or externally, may utilize a single valuation approach or a combination of approaches including the comparable sales, income and cost approach. Appraised amounts used in the impairment calculation are typically discounted 10 percent to account for selling and marketing costs, if the repayment of the loan is to come from the sale of the collateral. Although appraisals are not obtained each year on all impaired loans, the collateral values used in the impairment calculations are evaluated quarterly by management. Based on management’s knowledge of the collateral and the current real estate market conditions, appraised values may be further discounted to reflect facts and circumstances known to management since the most recent appraisal was performed.

Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a level 3 classification of the inputs for determining fair value. Because of the high degree of judgment required in estimating the fair value of collateral underlying impaired loans and because of the relationship between fair value and general economic conditions, we consider the fair value of impaired loans to be highly sensitive to changes in market conditions.

Premises and Equipment

Premises and equipment are recorded at acquisition cost net of accumulated depreciation.

Depreciation is charged to operations over the estimated useful lives of the assets. The estimated useful lives and methods of depreciation are as follows:

Description	Life in Years	Method
Banking Premises	15-40	Straight-Line and Accelerated
Furniture and Equipment	5 - 10	Straight-Line and Accelerated

Expenditures for major renewals and betterments are capitalized. Maintenance and repairs are charged to operations as incurred. When property and equipment are retired or sold, the cost and accumulated depreciation are removed from the respective accounts and any gain or loss is reflected in other income or expense.

Intangible Assets

Intangible assets consist of core deposit intangibles acquired in connection with a business combination. The core deposit intangible is initially recognized based on a valuation performed as of the consummation date. The core deposit intangible is amortized by the straight-line method over the average remaining life of the acquired customer deposits.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Statement of Cash Flows

For reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks and federal funds sold. Cash flows from demand deposits, interest-bearing checking accounts, savings accounts, loans and certificates of deposit are reported net.

Advertising Costs

The Company expenses the cost of advertising in the periods in which those costs are incurred.

Part I (Continued)

Item 2 (Continued)

(1) Summary of Significant Accounting Policies (Continued)

Income Taxes

The provision for income taxes is based upon income for financial statement purposes, adjusted for nontaxable income and nondeductible expenses. Deferred income taxes have been provided when different accounting methods have been used in determining income for income tax purposes and for financial reporting purposes.

Deferred tax assets and liabilities are recognized based on future tax consequences attributable to differences arising from the financial statement carrying values of assets and liabilities and their tax bases. The differences relate primarily to depreciable assets (use of different depreciation methods for financial statement and income tax purposes) and allowance for loan losses (use of the allowance method for financial statement purposes and the direct write-off method for tax purposes). In the event of changes in the tax laws, deferred tax assets and liabilities are adjusted in the period of the enactment of those changes, with effects included in the income tax provision. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company and its subsidiary file a consolidated federal income tax return. The subsidiary pays its proportional share of federal income taxes to the Company based on its taxable income.

Positions taken in the Company's tax returns may be subject to challenge by the taxing authorities upon examination. Uncertain tax positions are initially recognized in the consolidated financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. The Company provides for interest and, in some cases, penalties on tax positions that may be challenged by the taxing authorities. Interest expense is recognized beginning in the first period that such interest would begin accruing. Penalties are recognized in the period that the Company claims the position in the tax return. Interest and penalties on income tax uncertainties are classified within income tax expense in the consolidated statement of income.

Other Real Estate

Other real estate generally represents real estate acquired through foreclosure and is initially recorded at estimated fair value at the date of acquisition less the cost of disposal. Losses from the acquisition of property in full or partial satisfaction of debt are recorded as loan losses. Properties are evaluated regularly to ensure the recorded amounts are supported by current fair values, and valuation allowances are recorded as necessary to reduce the carrying amount to fair value less estimated cost of disposal. Routine holding costs and gains or losses upon disposition are included in other noninterest expense.

Bank-Owned Life Insurance

The Company has purchased life insurance on the lives of certain key members of management and directors. The life insurance policies are recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or amounts due that are probable at settlement, if applicable. Increases in the cash surrender value are recorded as other income in the consolidated statements of income. The cash surrender value of the insurance contracts is recorded in other assets on the consolidated balance sheets in the amount of \$14,557 and \$14,531 as of June 30, 2015 and December 31, 2014, respectively.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale, represent equity changes from economic events of the period other than transactions with owners and are not reported in the consolidated statements of operations but as a separate component of the equity section of the consolidated balance sheets. Such items are considered components of other comprehensive income (loss). Accounting standards codification requires the presentation in the consolidated financial statements of net income and all items of other comprehensive income (loss) as total comprehensive income (loss).

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

Part I (Continued)

Item 2 (Continued)

(1) Summary of Significant Accounting Policies (Continued)**Changes in Accounting Principles and Effects of New Accounting Pronouncements***Adoption of New Accounting Standards*

In May 2014, the FASB issued an update ASU No. 2014-09, *Revenue from Contracts with Customers creating FASB Topic 606, Revenue from Contracts with Customers*. The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The amendments in this update are effective for interim and annual reporting periods beginning after December 15, 2017. We are currently evaluating the impact of adopting the new guidance on the consolidated financial statements.

(2) Investment Securities

Investment securities as of June 30, 2015 and December 31, 2014 are summarized as follows:

June 30, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale:				
U.S. Government Agencies				
Mortgage-Backed	\$ 276,068	\$ 218	\$ (6,303) \$269,983

State, County & Municipal	3,903	27	(35))	3,895
	\$ 279,971	\$ 245	\$ (6,338))	\$273,878

Securities Held to Maturity:

State, County and Municipal	\$ 27	\$ -	\$ -		\$27
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December 31, 2014

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale:				
U.S. Government Agencies				
Mortgage-Backed	\$ 278,419	\$ 156	\$ (7,511)) \$271,064
State, County & Municipal	3,516	27	(13)) 3,530
	\$ 281,935	\$ 183	\$ (7,524)) \$274,594
Securities Held to Maturity:				
State, County and Municipal	\$ 30	\$ -	\$ -	\$30

Part I (Continued)

Item 2 (Continued)

(2) Investment Securities (Continued)

The amortized cost and fair value of investment securities as of June 30, 2015, by contractual maturity, are shown hereafter. Expected maturities will differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties. This is often the case with mortgage-backed securities, which are disclosed separately in the table below.

	Securities		Held to Maturity	
	Available for Sale		Amortized Cost	Fair Value
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due In One Year or Less	\$-	\$-	\$ 27	\$ 27
Due After One Year Through Five Years	1,118	1,125	-	-
Due After Five Years Through Ten Years	1,606	1,621	-	-
Due After Ten Years	1,179	1,149	-	-
	\$3,903	\$3,895	\$ 27	\$ 27
Mortgage-Backed Securities	276,068	269,983	-	-
	\$279,971	\$273,878	\$ 27	\$ 27

Proceeds from the sale of investments available for sale during the first six months of 2015 totaled \$25,173 compared to \$0 for the first six months of 2014. The sale of investments available for sale during the first six months of 2015 resulted in gross realized gains of \$199 and losses of \$196.

Investment securities having a carry value approximating \$123,419 and \$135,532 as of June 30, 2015 and December 31, 2014, respectively, were pledged to secure public deposits and for other purposes.

Information pertaining to securities with gross unrealized losses at June 30, 2015 and December 31, 2014 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
June 30, 2015						
U.S. Government Agencies						
Mortgage-Backed	\$77,965	\$ (537)	\$151,542	\$ (5,766)	\$229,507	\$ (6,303)
State, County and Municipal	2,108	(35)	-	-	2,108	(35)
	\$80,073	\$ (572)	\$151,542	\$ (5,766)	\$231,615	\$ (6,338)
December 31, 2014						
U.S. Government Agencies						
Mortgage-Backed	\$66,609	\$ (397)	\$183,646	\$ (7,114)	\$250,255	\$ (7,511)
State, County and Municipal	-	-	1,379	(13)	1,379	(13)
	\$66,609	\$ (397)	\$185,025	\$ (7,127)	\$251,634	\$ (7,524)

Part I (Continued)

Item 2 (Continued)

(2) Investments (Continued)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, 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 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 fair value.

At June 30, 2015, the debt securities with unrealized losses have depreciated 2.66 percent from the Company's amortized cost basis. These securities are guaranteed by either the U.S. Government, other governments or U.S. corporations. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other than temporary.

(3) Loans

The following table presents the composition of loans segregated by class of loans, as of June 30, 2015 and December 31, 2014.

	June 30, 2015	December 31, 2014
Commercial and Agricultural		
Commercial	\$52,506	\$ 50,960
Agricultural	24,019	16,689
Real Estate		
Commercial Constuction	46,699	51,259
Residential Construction	11,327	11,221
Commercial	341,167	332,231

Residential	202,805	203,753
Farmland	54,135	49,951
Consumer and Other		
Consumer	21,371	22,820
Other	6,049	7,210
Total Loans	\$760,078	\$ 746,094

Commercial and industrial loans are extended to a diverse group of businesses within the Company's market area. These loans are often underwritten based on the borrower's ability to service the debt from income from the business. Real estate construction loans often require loan funds to be advanced prior to completion of the project. Due to uncertainties inherent in estimating construction costs, changes in interest rates and other economic conditions, these loans often pose a higher risk than other types of loans. Consumer loans are originated at the bank level. These loans are generally smaller loan amounts spread across many individual borrowers to help minimize risk.

Credit Quality Indicators. As part of the ongoing monitoring of the credit quality of the loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk grade assigned to commercial and consumer loans, (ii) the level of classified commercial loans, (iii) net charge-offs, (iv) nonperforming loans, and (v) the general economic conditions in the Company's geographic markets.

The Company uses a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 8. A description of the general characteristics of the grades is as follows:

Part I (Continued)

Item 2 (Continued)

(3) Loans (Continued)

Grades 1 and 2 – Borrowers with these assigned grades range in risk from virtual absence of risk to minimal risk. Such loans may be secured by Company-issued and controlled certificates of deposit or properly margined equity securities or bonds. Other loans comprising these grades are made to companies that have been in existence for a long period of time with many years of consecutive profits and strong equity, good liquidity, excellent debt service ability and unblemished past performance, or to exceptionally strong individuals with collateral of unquestioned value that fully secures the loans. Loans in this category fall into the “pass” classification.

Grades 3 and 4 – Loans assigned these “pass” risk grades are made to borrowers with acceptable credit quality and risk. The risk ranges from loans with no significant weaknesses in repayment capacity and collateral protection to acceptable loans with one or more risk factors considered to be more than average.

Grade 5 – This grade includes “special mention” loans on management’s watch list and is intended to be used on a temporary basis for pass grade loans where risk-modifying action is intended in the short-term.

Grade 6 – This grade includes “substandard” loans in accordance with regulatory guidelines. This category includes borrowers with well-defined weaknesses that jeopardize the payment of the debt in accordance with the agreed terms. Loans considered to be impaired are assigned this grade, and these loans often have assigned loss allocations as part of the allowance for loan and lease losses. Generally, loans on which interest accrual has been stopped would be included in this grade.

Grades 7 and 8 – These grades correspond to regulatory classification definitions of “doubtful” and “loss,” respectively. In practice, any loan with these grades would be for a very short period of time, and generally the Company has no loans with these assigned grades. Management manages the Company’s problem loans in such a way that uncollectible loans or uncollectible portions of loans are charged off immediately with any residual, collectible amounts assigned a risk grade of 6.

The following table presents the loan portfolio by credit quality indicator (risk grade) as of June 30, 2015 and December 31, 2014. Those loans with a risk grade of 1, 2, 3 or 4 have been combined in the pass column for presentation purposes.

June 30, 2015

	Pass	Special Mention	Substandard	Total Loans
Commercial and Agricultural				
Commercial	\$49,301	\$ 1,400	\$ 1,805	\$52,506
Agricultural	23,831	27	161	24,019
Real Estate				
Commercial Construction	40,923	1,476	4,300	46,699
Residential Construction	11,327	-	-	11,327
Commercial	321,278	9,713	10,176	341,167
Residential	180,884	12,726	9,195	202,805
Farmland	52,192	380	1,563	54,135
Consumer and Other				
Consumer	20,749	204	418	21,371
Other	6,047	1	1	6,049
Total Loans	\$706,532	\$ 25,927	\$ 27,619	\$760,078

Part I (Continued)

Item 2 (Continued)

(3) Loans (Continued)**December 31, 2014**

	Pass	Special Mention	Substandard	Total Loans
Commercial and Agricultural				
Commercial	\$46,230	\$ 2,905	\$ 1,825	\$50,960
Agricultural	16,504	27	158	16,689
Real Estate				
Commercial Construction	45,063	1,741	4,455	51,259
Residential Construction	11,221	-	-	11,221
Commercial	309,828	11,220	11,183	332,231
Residential	180,550	10,582	12,621	203,753
Farmland	47,548	415	1,988	49,951
Consumer and Other				
Consumer	22,115	249	456	22,820
Other	7,013	-	197	7,210
Total Loans	\$686,072	\$ 27,139	\$ 32,883	\$746,094

A loan's risk grade is assigned at the inception of the loan and is based on the financial strength of the borrower and the type of collateral. Loan risk grades are subject to reassessment at various times throughout the year as part of the Company's ongoing loan review process. Loans with an assigned risk grade of 6 or below and an outstanding balance of \$250,000 or more are reassessed on a quarterly basis. During this reassessment process individual reserves may be identified and placed against certain loans which are not considered impaired.

In assessing the overall economic condition of the markets in which it operates, the Company monitors the unemployment rates for its major service areas. The unemployment rates are reviewed on a quarterly basis as part of the allowance for loan loss determination.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due or when, in management's opinion, the borrower may be unable to meet payment obligations as they

become due, as well as when required by regulatory provision. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due.

Part I (Continued)

Item 2 (Continued)

(3) Loans (Continued)

The following table represents an age analysis of past due loans and nonaccrual loans, segregated by class of loans, as of June 30, 2015 and December 31, 2014:

June 30, 2015

	Accruing Loans 90 Days			Nonaccrual Loans	Current Loans	Total Loans
	30-89 Days Past Due	or More Past Due	Total Accruing Loans Past Due			
Commercial and Agricultural						
Commercial	\$423	\$ -	\$ 423	\$ 739	\$51,344	\$52,506
Agricultural	99	-	99	162	23,758	24,019
Real Estate						
Commercial Construction	84	-	84	3,152	43,463	46,699
Residential Construction	255	-	255	-	11,072	11,327
Commercial	1,379	-	1,379	4,905	334,883	341,167
Residential	4,098	-	4,098	3,516	195,191	202,805
Farmland	468	-	468	1,442	52,225	54,135
Consumer and Other						
Consumer	416	8	424	204	20,743	21,371
Other	-	-	-	-	6,049	6,049
Total Loans	\$7,222	\$ 8	\$ 7,230	\$ 14,120	\$738,728	\$760,078

December 31, 2014

	Accruing Loans 90 Days			Nonaccrual
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	30-89 or Days Past Due	or More Past Due	Total Accruing Loans Past Due	Loans	Current Loans	Total Loans
Commercial and Agricultural						
Commercial	\$872	\$ -	\$ 872	\$ 405	\$49,683	\$50,960
Agricultural	-	-	-	45	16,644	16,689
Real Estate						
Commercial Construction	142	-	142	3,251	47,866	51,259
Residential Construction	-	-	-	-	11,221	11,221
Commercial						