COLONY BANKCORP INC
Form 10-Q
May 06, 2013

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 MARCH 31, 2013 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 INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER 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 x NO o

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 x NO o

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 o	ACCELERATED FILER o
NON-ACCELERATED FILER o	SMALLER REPORTING COMPANY x
(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 o NO x

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

CLASS	OUTSTANDING AT MAY 6, 2013
COMMON STOCK, $1 PAR VALUE	8,439,258

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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), not withstanding 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; (ii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes," "anticipates," "expects," "intends," "targete 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.
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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.
- Restrictions or conditions imposed by our regulators on our operations, including the terms of our Memorandum of Understanding.

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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).

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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 – MARCH 31, 2013 (UNAUDITED) AND DECEMBER 31, 2012.

B. CONSOLIDATED STATEMENTS OF INCOME – FOR THE THREE MONTHS ENDED MARCH 31, 2013 AND 2012 (UNAUDITED).

C. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME – FOR THE THREE MONTHS ENDED MARCH 31, 2013 AND 2012 (UNAUDITED).

D. CONSOLIDATED STATEMENTS OF CASH FLOWS – FOR THE THREE MONTHS ENDED MARCH 31, 2013 AND 2012 (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 THREE MONTH PERIOD ENDED MARCH 31, 2013 ARE NOT NECESSARILY INDICATIVE OF THE RESULTS TO BE EXPECTED FOR THE FULL YEAR.

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COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
MARCH 31, 2013 AND DECEMBER 31, 2012
(DOLLARS IN THOUSANDS)

ASSETS	March 31, 2013 (Unaudited)	December 31, 2012 (Audited)
Cash and Cash Equivalents		
Cash and Due from Banks	$ 18,608	$ 29,244
Federal Funds Sold	10,966	20,002
	29,574	49,246
Interest-Bearing Deposits	8,706	21,795
Investment Securities		
Available for Sale, at Fair Value	288,249	268,301
Held to Maturity, at Cost (Fair Value of $43 and $42, as of March 31, 2013 and December 31, 2012, Respectively)	43	41
	288,292	268,342
Federal Home Loan Bank Stock, at Cost	3,164	3,364
Loans	736,820	747,050
Allowance for Loan Losses	(12,930)	(12,737)
Unearned Interest and Fees	(239)	(234)
	723,651	734,079
Premises and Equipment	25,071	24,916
Other Real Estate (Net of Allowance of $4,917 and $4,561 as of March 31, 2013 and December 31, 2012, Respectively)	18,771	15,941
Other Intangible Assets	215	224
Other Assets	21,421	21,490
Total Assets	$ 1,118,865	$ 1,139,397
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-Bearing	$ 121,921	$ 123,967
Interest-Bearing	831,654	855,718
	953,575	979,685
Borrowed Money		
Subordinated Debentures	24,229	24,229
Other Borrowed Money	40,000	35,000
	64,229	59,229
Other Liabilities	5,624	4,724
Commitments and Contingencies		
Stockholders' Equity		

Preferred Stock, Stated Value $1,000 a Share; Authorized 10,000,000 Shares, Issued 28,000 Shares	27,870	27,827
Common Stock, Par Value $1 a Share; Authorized 20,000,000 Shares, Issued 8,439,258 and 8,439,258 Shares as of March 31, 2013 and December 31, 2012, Respectively	8,439	8,439
Paid-In Capital	29,145	29,145
Retained Earnings	31,022	30,498
Accumulated Other Comprehensive (Loss), Net of Tax	(1,039)	(150)
	95,437	95,759
Total Liabilities and Stockholders' Equity	$ 1,118,865	$ 1,139,397

The accompanying notes are an integral part of these statements.

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COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED MARCH 31, 2013 AND 2012
(UNAUDITED)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended	
	March 31, 2013	March 31, 2012
Interest Income		
Loans, Including Fees	$10,361	$10,420
Federal Funds Sold	14	26
Deposits with Other Banks	11	20
Investment Securities		
U.S. Government Agencies	712	1,619
State, County and Municipal	33	66
Corporate Obligations and Asset-Backed Securities	14	23
Dividends on Other Investments	19	17
	11,164	12,191
Interest Expense		
Deposits	1,686	2,470
Borrowed Money	432	837
	2,118	3,307
Net Interest Income	9,046	8,884
Provision for Loan Losses	1,500	1,942
Net Interest Income After Provision for Loan Losses	7,546	6,942
Noninterest Income		
Service Charges on Deposits	1,101	796
Other Service Charges, Commissions and Fees	404	419
Mortgage Fee Income	119	81
Securities Gains	(8)	137
Other	594	381
	2,210	1,814
Noninterest Expenses		
Salaries and Employee Benefits	4,169	3,820
Occupancy and Equipment	933	938
Other	3,290	3,225
	8,392	7,983
Income Before Income Taxes	1,364	773
Income Taxes	427	232
Net Income	937	541
Preferred Stock Dividends	370	352
Net Income Available to Common Stockholders	$567	$189

Net Income Per Share of Common Stock		
Basic	$0.07	$0.02
Diluted	$0.07	$0.02
Cash Dividends Declared Per Share of Common Stock	$0.00	$0.00
Weighted Average Basic Shares Outstanding	8,439,258	8,439,258
Weighted Average Diluted Shares Outstanding	8,439,258	8,439,258

The accompanying notes are an integral part of these statements.

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Part I (Continued)
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COLONY BANKCORP INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
THREE MONTHS ENDED MARCH 31, 2013 AND 2012
(UNAUDITED)
(DOLLARS IN THOUSANDS)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Net Income	$937	$541
Other Comprehensive Income (Loss), Net of Tax		
Gains (Losses) on Securities Arising During the Year	(894)	415
Reclassification Adjustment	5	(91)
Change in Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effect	(889)	324
Comprehensive Income	$48	$865

The accompanying notes are an integral part of these statements.

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COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED MARCH 31, 2013 AND 2012
(UNAUDITED)
(DOLLARS IN THOUSANDS)

	Three Months Ended March 31, 2013	March 31, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$937	$541
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	387	402
Provision for Loan Losses	1,500	1,942
Securities (Gains) Losses	8	(137)
Amortization and Accretion	939	1,016
(Gain) Loss on Sale of Other Real Estate and Repossessions	(94)	121
Provision for Losses on Other Real Estate	500	350
Increase in Cash Surrender Value of Life Insurance	(53)	(62)
Other Prepaids, Deferrals and Accruals, Net	1,176	2,175
	5,300	6,348
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Investment Securities Available for Sale	(68,394)	(46,858)
Proceeds from Maturities, Calls, and Paydowns of Investment Securities:		
Available for Sale	15,764	10,709
Proceeds from Sale of Investment Securities		
Available for Sale	30,418	6,082
Decrease in Interest-Bearing Deposits in Other Banks	13,089	906
Net Loans to Customers	3,474	4,815
Purchase of Premises and Equipment	(541)	(424)
Proceeds from Sale of Other Real Estate and Repossessions	2,129	2,346
Proceeds from Sale of FHLB Stock	200	--
	(3,861)	(22,424)
CASH FLOWS FROM FINANCING ACTIVITIES		
Noninterest-Bearing Customer Deposits	(2,046)	11,204
Interest-Bearing Customer Deposits	(24,065)	(17,175)
Proceeds (Payments) from Other Borrowed Money	5,000	(13,500)
	(21,111)	(19,471)
Net Decrease in Cash and Cash Equivalents	(19,672)	(35,547)
Cash and Cash Equivalents at Beginning of Period	49,246	83,372
Cash and Cash Equivalents at End of Period	$29,574	$47,825

The accompanying notes are an integral part of these statements.

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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.

The consolidated financial statements in this report are unaudited, except for the December 31, 2012 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 three months ended March 31, 2013, 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, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans and the valuation of deferred tax assets.

Reclassifications

In certain instances, amounts reported in prior years' consolidated financial statements have been reclassified to conform to statement presentations selected for 2013. 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 March 31, 2013, approximately 87 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. The downturn of the housing and real estate market that began in 2007 resulted in an increase of problem loans secured by real estate, of which most are centered in the Company’s larger MSA markets. 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.

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Part I (Continued)
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(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 rating is 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.

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(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.

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Part I (Continued)
Item 1 (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 initial 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, NOW 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.

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Part I (Continued)
Item 1 (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 foreclosed property expense.

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.

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(2) Investment Securities

Investment securities as of March 31, 2013 and December 31, 2012 are summarized as follows:

March 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale:				
U.S. Government Agencies				
Mortgage-Backed	$ 284,283	$ 471	$ (1,944)	$ 282,810
State, County & Municipal	4,173	44	(8)	4,209
Corporate Obligations	1,000	98	--	1,098
Asset-Backed Securities	367	--	(235)	132
	$ 289,823	$ 613	$ (2,187)	$ 288,249
Securities Held to Maturity:				
State, County and Municipal	$ 43	$ --	$ --	$ 43

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale:				
U.S. Government Agencies				
Mortgage-Backed	$ 263,187	$ 835	$ (962)	$ 263,060
State, County & Municipal	3,974	34	(4)	4,004
Corporate Obligations	1,000	105	--	1,105
Asset-Backed Securities	366	--	(234)	132
	$ 268,527	$ 974	$ (1,200)	$ 268,301
Securities Held to Maturity:				
State, County and Municipal	$ 41	$ 1	$ --	$ 42

The amortized cost and fair value of investment securities as of March 31, 2013, 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			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due After One Year Through Five Years	$ 2,754	$ 2,882	$ 43	$ 43
Due After Five Years Through Ten Years	1,765	1,779	--	--
Due After Ten Years	1,021	778	--	--
	5,540	5,439	43	43

Mortgage-Backed Securities		284,283		282,810		--		--
	$	289,823	$	288,249	$	43	$	43

Proceeds from the sale of investments available for sale during first three months of 2013 totaled $30,418 compared to $6,082 for the first three months of 2012. The sale of investments available for sale during 2013 resulted in gross realized gains of $125 and losses of $(133). The sale of investments available for sale during the first three months of 2012 resulted in gross realized gains of $197. This was offset by other than temporary impairment charges of $(60).

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(2) Investment Securities (Continued)

Nonaccrual securities are securities for which principal and interest are doubtful of collection in accordance with original terms and for which accruals of interest have been discontinued due to payment delinquency. Fair value of securities on nonaccrual status totaled $132 and $132 as of March 31, 2013 and December 31, 2012, respectively.

Investment securities having a carry value approximating $118,473 and $117,451 as of March 31, 2013 and December 31, 2012, respectively, were pledged to secure public deposits and for other purposes.

Information pertaining to securities with gross unrealized losses at March 31, 2013 and December 31, 2012 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
March 31, 2013						
U.S. Government Agencies						
Mortgage-Backed	$200,421	$(1,944)	$--	$--	$200,421	$(1,944)
State, County and Municipal	646	(8)	--	--	646	(8)
Asset-Backed Securities	--	--	132	(235)	132	(235)
	$201,067	$(1,952)	$132	$(235)	$201,199	$(2,187)
December 31, 2012						
U.S. Government Agencies						
Mortgage-Backed	$142,104	$(962)	$--	$--	$142,104	$(962)
State, County and Municipal	1,431	(4)	--	--	1,431	(4)
Asset-Backed Securities	--	--	132	(234)	132	(234)
	$143,535	$(966)	$132	$(234)	$143,667	$(1,200)

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 March 31, 2013, the debt securities with unrealized losses have depreciated 1.07 percent from the Company's amortized cost basis. These securities are guaranteed by either the U.S. Government, other governments or U.S. corporations, except for asset-backed securities. 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. However, the Company did own one asset-backed security at March 31, 2013 which has been in a continuous unrealized loss position for more than twelve months. This investment is comprised of one issuance of a trust preferred security, has a book value of $367 and an unrealized loss of $235. Management evaluates this investment on a quarterly basis utilizing a third-party valuation model. The Company does not intend to sell this investment, nor does the Company consider it likely that it will be required to sell the investment prior to recovery of the remaining fair value.

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Part I (Continued)
Item 1 (Continued)

(3) Loans

The following table presents the composition of loans segregated by class of loans, as of March 31, 2013 and December 31, 2012.

	March 31, 2013	December 31, 2012
Commercial and Agricultural		
Commercial	$52,906	$55,684
Agricultural	7,856	6,211
Real Estate		
Commercial Construction	52,094	53,808
Residential Construction	7,570	5,852
Commercial	328,852	334,386
Residential	204,658	203,845
Farmland	48,208	49,057
Consumer and Other		
Consumer	28,379	29,778
Other	6,297	8,429
Total Loans	$736,820	$747,050

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:

- 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.

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Part I (Continued)
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- 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 March 31, 2013 and December 31, 2012. Those loans with a risk grade of 1, 2, 3 or 4 have been combined in the pass column for presentation purposes.

March 31, 2013

	Pass	Special Mention	Substandard	Total Loans
Commercial and Agricultural				
Commercial	$47,848	$1,821	$3,237	$52,906
Agricultural	7,775	16	65	7,856
Real Estate				
Commercial Construction	39,650	1,965	10,479	52,094
Residential Construction	7,401	169	--	7,570
Commercial	302,856	9,062	16,934	328,852
Residential	185,951	10,126	8,581	204,658
Farmland	44,378	1,278	2,552	48,208
Consumer and Other				
Consumer	27,267	366	746	28,379
Other	6,229	4	64	6,297
Total Loans	$669,355	$24,807	$42,658	$736,820

December 31, 2012

	Pass	Special Mention	Substandard	Total Loans
Commercial and Agricultural				
Commercial	$49,947	$1,418	$4,319	$55,684
Agricultural	6,156	--	55	6,211
Real Estate				
Commercial Construction	37,256	1,664	14,888	53,808
Residential Construction	5,749	103	--	5,852
Commercial	298,222	9,759	26,405	334,386
Residential	183,222	11,413	9,210	203,845
Farmland	45,495	914	2,648	49,057
Consumer and Other				
Consumer	28,840	293	645	29,778

Other	8,351	9	69	8,429
Total Loans	$663,238	$25,573	$ 58,239	$747,050

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

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(3) Loans (Continued)

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. Nonaccrual loans totaled $20,439 and $29,851 as of March 31, 2013 and December 31, 2012, respectively, and total recorded investment in loans past due 90 days or more and still accruing interest approximated $0 and $4, respectively. During its review of impaired loans, the company determined the majority of its exposures on these loans were known losses. As a result, the exposures were charged off, reducing the specific allowances on impaired loans.

The following table represents an age analysis of past due loans and nonaccrual loans, segregated by class of loans, as of March 31, 2013 and December 31, 2012:

March 31, 2013

	30-89 Days Past Due	Accruing Loans 90 Days or More Past Due	Total Accruing Loans Past Due	Nonaccrual Loans	Current Loans	Total Loans
Commercial and Agricultural						
Commercial	$604	$--	$604	$33	$52,269	$52,906
Agricultural	--	--	--	39	7,817	7,856
Real Estate						
Commercial Construction	1,498	--	1,498	9,652	40,944	52,094
Residential Construction	--	--	--	--	7,570	7,570
Commercial	3,691	--	3,691	3,761	321,400	328,852
Residential	3,426	--	3,426	4,189	197,043	204,658
Farmland	1,460	--	1,460	2,548	44,200	48,208
Consumer and Other						
Consumer	652	--	652	217	27,510	28,379
Other	--	--	--	--	6,297	6,297
Total Loans	$11,331	$--	$11,331	$20,439	$705,050	$736,820

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Part I (Continued)
Item 1 (Continued)

(3) Loans (Continued)

December 31, 2012

	30-89 Days Past Due	Accruing Loans 90 Days or More Past Due	Total Accruing Loans Past Due	Nonaccrual Loans	Current Loans	Total Loans
Commercial and Agricultural						
Commercial	$798	$--	$798	$1,033	$53,853	$55,684
Agricultural	28	--	28	39	6,144	6,211
Real Estate						
Commercial Construction	1,310	--	1,310	14,032	38,466	53,808
Residential Construction	--	--	--	--	5,852	5,852
Commercial	3,771	--	3,771	6,630	323,985	334,386
Residential	8,223	--	8,223	5,430	190,192	203,845
Farmland	140	--	140	2,413	46,504	49,057
Consumer and Other						
Consumer	637	4	641	256	28,881	29,778
Other	5	--	5	18	8,406	8,429
Total Loans	$14,912	$4	$14,916	$29,851	$702,283	$747,050

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Part I (Continued)
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(3) Loans (Continued)

The following table details impaired loan data as of March 31, 2013:

March 31, 2013

	Unpaid Contractual Principal Balance	Impaired Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Collected
With No Related Allowance Recorded						
Commercial	$264	$122	$--	$122	$3	$4
Agricultural	39	39	--	39	--	--
Commercial Construction	9,002	4,962	--	4,962	4	5
Residential Construction	--	--	--	--	--	--
Commercial Real Estate	15,405	15,331	--	15,331	102	129
Residential Real Estate	2,726	2,382	--	2,382	10	18
Farmland	2,590	2,548	--	2,548	(1)	3
Consumer	229	217	--	217	--	2
Other	--	--	--	--	--	--
	30,255	25,601	--	25,601	118	161
With An Allowance Recorded						
Commercial	1,465	1,465	456	1,465	20	17
Agricultural	--	--	--	--	--	--
Commercial Construction	5,339	4,690	1,493	4,690	--	1
Residential Construction	--	--	--	--	--	--
Commercial Real Estate	10,077	9,917	1,426	9,917	73	91
Residential Real Estate	6,959	5,916	1,118	5,916	40	36
Farmland	--	--	--	--	--	--
Consumer	--	--	--	--	--	--
Other	--	--	--	--	--	--
	23,840	21,988	4,493	21,988	133	145
Total						
Commercial	1,729	1,587	456	1,587	23	21
Agricultural	39	39	--	39	--	--
Commercial Construction	14,341	9,652	1,493	9,652	4	6
Residential Construction	--	--	--	--	--	--
Commercial Real Estate	25,482	25,248	1,426	25,248	175	220
Residential Real Estate	9,685	8,298	1,118	8,298	50	54
Farmland	2,590	2,548	--	2,548	(1)	3
Consumer	229	217	--	217	--	2

Other	--	--	--	--	--	--
	$54,095	$47,589	$4,493	$47,589	$251	$306

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Part I (Continued)
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(3) Loans (Continued)

The following table details impaired loan data as of December 31, 2012:

December 31, 2012	Unpaid Contractual Principal Balance	Impaired Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Collected
With No Related Allowance Recorded						
Commercial	$1,508	$1,042	$--	$1,053	$27	$28
Agricultural	39	39	--	58	--	--
Commercial Construction	10,625	6,415	--	9,194	27	52
Residential Construction	--	--	--	--	--	--
Commercial Real Estate	16,566	15,506	--	26,482	430	421
Residential Real Estate	4,450	4,132	--	3,096	89	123
Farmland	2,829	2,413	--	2,326	43	55
Consumer	297	255	--	228	10	13
Other	18	18	--			