UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2018

OR

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

For the transition period from ____________ to ____________

Commission File Number: 0-13358

(Exact name of registrant as specified in its charter)

Florida	**59-2273542**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
217 North Monroe Street, Tallahassee, Florida	**32301**
(Address of principal executive office)	(Zip Code)

(850) 402-7821
(Registrant's telephone number, including area code)

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

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

Large accelerated filer [ ]	Accelerated filer [X]	Non-accelerated filer [ ] (Do not check if smaller reporting company)	Smaller reporting company [ ] Emerging growth company [ ]

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

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

At July 31, 2018, 17,055,664 shares of the Registrant's Common Stock, $.01 par value, were outstanding.

CAPITAL CITY BANK GROUP, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE PERIOD ENDED JUNE 30, 2018

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INTRODUCTORY NOTE

Caution Concerning Forward-Looking Statements

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

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

Our ability to achieve our financial objectives could be adversely affected by the factors discussed in detail in Part I, Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Part II, Item 1A. "Risk Factors" in this Quarterly Report on Form 10-Q and the following sections of our Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K"): (a) "Introductory Note" in Part I, Item 1. "Business"; (b) "Risk Factors" in Part I, Item 1A, as updated in our subsequent quarterly reports filed on Form 10-Q; and (c) "Introduction" in "Management's Discussion and Analysis of Financial Condition and Results of Operations," in Part II, Item 7, as well as:

- our ability to successfully manage interest rate risk, liquidity risk, and other risks inherent to our industry;
- legislative or regulatory changes, the ability to repay and qualified mortgage standards;
- the effects of security breaches and computer viruses that may affect our computer systems or fraud related to debit card products;
- the accuracy of our financial statement estimates and assumptions, including the estimates used for our loan loss provision, deferred tax asset valuation and pension plan;
- the frequency and magnitude of foreclosure of our loans;
- the effects of our lack of a diversified loan portfolio, including the risks of geographic and industry concentrations;
- the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- our ability to declare and pay dividends, the payment of which is now subject to our compliance with heightened capital requirements;

- changes in the securities and real estate markets;
- changes in monetary and fiscal policies of the U.S. Government;
- inflation, interest rate, market and monetary fluctuations;
- the effects of harsh weather conditions, including hurricanes, and man-made disasters;
- our ability to comply with the extensive laws and regulations to which we are subject, including the laws for each jurisdiction where we operate;
- the willingness of clients to accept third-party products and services rather than our products and services and vice versa;
- increased competition and its effect on pricing;
- technological changes;
- negative publicity and the impact on our reputation;
- changes in consumer spending and saving habits;
- growth and profitability of our noninterest income;
- changes in accounting principles, policies, practices or guidelines;
- the limited trading activity of our common stock;
- the concentration of ownership of our common stock;
- anti-takeover provisions under federal and state law as well as our Articles of Incorporation and our Bylaws;
- other risks described from time to time in our filings with the Securities and Exchange Commission; and
- our ability to manage the risks involved in the foregoing.

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

PART I. FINANCIAL INFORMATION
Item 1.

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

(Dollars in Thousands)	**(Unaudited) June 30, 2018**	**December 31, 2017**
ASSETS		
Cash and Due From Banks	$ 56,573	$ 58,419
Federal Funds Sold and Interest Bearing Deposits	107,066	227,023
Total Cash and Cash Equivalents	163,639	285,442
Investment Securities, Available for Sale, at fair value	493,662	480,911
Investment Securities, Held to Maturity, at amortized cost (fair value of $233,179 and $215,007)	236,764	216,679
Total Investment Securities	730,426	697,590
Loans Held For Sale	8,246	4,817
Loans, Net of Unearned Income	1,724,475	1,653,492
Allowance for Loan Losses	(13,563)	(13,307)
Loans, Net	1,710,912	1,640,185
Premises and Equipment, net	90,000	91,698
Goodwill	84,811	84,811
Other Real Estate Owned	3,373	3,941
Other Assets	88,871	90,310
Total Assets	$ 2,880,278	$ 2,898,794
LIABILITIES		
Deposits:		
Noninterest Bearing Deposits	$ 937,241	$ 874,583
Interest Bearing Deposits	1,521,949	1,595,294
Total Deposits	2,459,190	2,469,877
Short-Term Borrowings	7,021	7,480
Subordinated Notes Payable	52,887	52,887
Other Long-Term Borrowings	12,897	13,967
Other Liabilities	54,712	70,373
Total Liabilities	2,586,707	2,614,584
SHAREOWNERS' EQUITY		
Preferred Stock, $.01 par value; 3,000,000 shares authorized; no shares issued and outstanding	-	-
Common Stock, $.01 par value; 90,000,000 shares authorized; 17,055,664 and 16,988,951 shares	171	170

issued and outstanding at June 30, 2018 and December 31, 2017, respectively		
Additional Paid-In Capital	37,932	36,674
Retained Earnings	288,800	279,410
Accumulated Other Comprehensive Loss, net of tax	(33,332)	(32,044)
Total Shareowners’ Equity	293,571	284,210
Total Liabilities and Shareowners' Equity	$ 2,880,278	$ 2,898,794

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in Thousands, Except Per Share Data)	**2018**	**2017**	**2018**	**2017**
INTEREST INCOME				
Loans, including Fees	$ 20,533	$ 18,720	$ 40,068	$ 36,725
Investment Securities:				
Taxable	2,944	1,899	5,467	3,682
Tax Exempt	212	270	451	529
Federal Funds Sold and Interest Bearing Deposits	730	533	1,647	1,026
Total Interest Income	24,419	21,422	47,633	41,962
INTEREST EXPENSE				
Deposits	995	388	1,863	669
Short-Term Borrowings	8	17	16	62
Subordinated Notes Payable	552	404	1,027	783
Other Long-Term Borrowings	94	117	194	216
Total Interest Expense	1,649	926	3,100	1,730
NET INTEREST INCOME	22,770	20,496	44,533	40,232
Provision for Loan Losses	815	589	1,560	899
Net Interest Income After Provision For Loan Losses	21,955	19,907	42,973	39,333
NONINTEREST INCOME				
Deposit Fees	4,842	5,052	9,714	10,142
Bank Card Fees	2,909	2,870	5,720	5,673
Wealth Management Fees	2,037	2,073	4,210	3,915
Mortgage Banking Fees	1,206	1,556	2,263	2,864
Other	1,548	1,584	3,112	3,259
Total Noninterest Income	12,542	13,135	25,019	25,853
NONINTEREST EXPENSE				
Compensation	15,797	15,641	31,708	31,500
Occupancy, net	4,503	4,555	9,054	8,936
Other Real Estate Owned, net	248	315	874	898
Other	7,845	7,410	14,663	14,509
Total Noninterest Expense	28,393	27,921	56,299	55,843
INCOME BEFORE INCOME TAXES	6,104	5,121	11,693	9,343
Income Tax Expense (Benefit)	101	1,560	(83)	3,038
NET INCOME	**$ 6,003**	**$ 3,561**	**$ 11,776**	**$ 6,305**

BASIC NET INCOME PER SHARE	**$ 0.35**	**$ 0.21**	**$ 0.69**	**$ 0.37**
DILUTED NET INCOME PER SHARE	**$ 0.35**	**$ 0.21**	**$ 0.69**	**$ 0.37**
Average Common Basic Shares Outstanding	17,045	16,955	17,037	16,937
Average Common Diluted Shares Outstanding	17,104	17,016	17,089	16,993

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in Thousands)	**2018**	**2017**	**2018**	**2017**
NET INCOME	$ 6,003	$ 3,561	$ 11,776	$ 6,305
Other comprehensive income, before tax:				
Change in net unrealized gain/loss on securities available for sale	(265)	110	(1,752)	615
Amortization of unrealized losses on securities transferred from available for sale to held to maturity	14	18	28	38
Total Investment Securities	(251)	128	(1,724)	653
Other comprehensive (loss) income, before tax	(251)	128	(1,724)	653
Deferred tax (benefit) expense related to other comprehensive income	(63)	49	(436)	253
Other comprehensive (loss) income, net of tax	(188)	79	(1,288)	400
TOTAL COMPREHENSIVE INCOME	$ 5,815	$ 3,640	$ 10,488	$ 6,705

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

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

(Dollars In Thousands, Except Share Data)	**Shares Outstanding**	**Common Stock**	**Additional Paid-In Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Loss, Net of Taxes**	**Total**
Balance, January 1, 2017	16,844,698	$ 168	$ 34,188	$ 267,037	$ (26,225)	$ 275,168
Net Income	-	-	-	6,305	-	6,305
Other Comprehensive Income, net of tax	-	-	-	-	400	400
Cash Dividends ($0.1000 per share)	-	-	-	(1,696)	-	(1,696)
Stock Based Compensation	-	-	869	-	-	869
Impact of Transactions Under Compensation Plans, net	119,317	2	465	-	-	467
Balance, June 30, 2017	16,964,015	$ 170	$ 35,522	$ 271,646	$ (25,825)	$ 281,513
Balance, January 1, 2018	16,988,951	$ 170	$ 36,674	$ 279,410	$ (32,044)	$ 284,210
Net Income	-	-	-	11,776	-	11,776
Other Comprehensive Income, net of tax	-	-	-	-	(1,288)	(1,288)
Cash Dividends ($0.1400 per share)	-	-	-	(2,386)	-	(2,386)
Stock Based Compensation	-	-	655	-	-	655
Impact of Transactions Under Compensation Plans, net	66,713	1	603	-	-	604
Balance, June 30, 2018	17,055,664	$ 171	$ 37,932	$ 288,800	$ (33,332)	$ 293,571

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

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

	Six Months Ended June 30,	
(Dollars in Thousands)	**2018**	**2017**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$ 11,776	$ 6,305
Adjustments to Reconcile Net Income to		
Cash Provided by Operating Activities:		
Provision for Loan Losses	1,560	899
Depreciation	3,218	3,352
Amortization of Premiums, Discounts, and Fees, net	3,495	3,279
Net (Increase) Decrease in Loans Held-for-Sale	(3,429)	2,673
Stock Compensation	655	869
Net Tax Benefit From Stock-Based Compensation	(41)	(223)
Deferred Income Taxes	2,156	944
Net Loss on Sales and Write-Downs of Other Real Estate Owned	693	695
Loss on Disposal of Premises and Equipment	-	260
Net Decrease in Other Assets	541	7,026
Net (Decrease) Increase in Other Liabilities	(15,468)	9,948
Net Cash Provided By Operating Activities	5,156	36,027
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities Held to Maturity:		
Purchases	(84,617)	(28,298)
Payments, Maturities, and Calls	63,724	48,096
Securities Available for Sale:		
Purchases	(102,974)	(87,273)
Payments, Maturities, and Calls	84,991	77,973
Purchases of Loans Held for Investment	(16,106)	(35,499)
Net Increase in Loans	(56,981)	(26,101)
Proceeds From Sales of Other Real Estate Owned	715	3,393
Purchases of Premises and Equipment	(1,520)	(1,534)
Net Cash Used In Investing Activities	(112,768)	(49,243)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net Decrease in Deposits	(10,687)	(40,353)
Net Decrease in Short-Term Borrowings	(459)	(3,644)
Repayment of Other Long-Term Borrowings	(1,070)	(2,250)
Dividends Paid	(2,386)	(1,696)
Issuance of Common Stock Under Compensation Plans	411	290
Net Cash Used In Financing Activities	(14,191)	(47,653)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(121,803)	(60,869)
Cash and Cash Equivalents at Beginning of Period	285,442	296,047
Cash and Cash Equivalents at End of Period	$ 163,639	$ 235,178

Supplemental Cash Flow Disclosures:		
Interest Paid	$ 3,103	$ 1,748
Income Taxes Paid	$ 101	$ 4,024
Noncash Investing and Financing Activities:		
Loans Transferred to Other Real Estate Owned	$ 840	$ 1,685

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

CAPITAL CITY BANK GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

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

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

The consolidated statement of financial condition at December 31, 2017 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2017.

Accounting Changes

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

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

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

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

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

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

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

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

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

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

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

Period Presented	Line Item	
(Dollars in Thousands)	Compensation	Other Expense
Three Months Ended June 30, 2018	($457)	$457
Three Months Ended June 30, 2017	($651)	$651
Six Months Ended June 30, 2018	($914)	$914
Six Months Ended June 30, 2017	($1,288)	$1,288

NOTE 2 – INVESTMENT SECURITIES

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

	June 30, 2018				December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value	Amortized Cost	Unrealized Gain	Unrealized Losses	Market Value
Available for Sale								
U.S. Government Treasury	$262,471	$ 12	$ 3,745	$258,738	$237,505	$ -	$ 2,164	$235,341
U.S. Government Agency	159,906	656	653	159,909	144,324	727	407	144,644
States and Political Subdivisions	66,348	1	218	66,131	91,533	2	378	91,157
Mortgage-Backed Securities	940	58	-	998	1,102	83	-	1,185
Equity Securities[(1)]	7,886	-	-	7,886	8,584	-	-	8,584
Total	$497,551	$ 727	$ 4,616	$493,662	$483,048	$ 812	$ 2,949	$480,911
Held to Maturity								
U.S. Government Treasury	$ 50,124	$ -	$ 668	$ 49,456	$ 98,256	$ -	$ 441	$ 97,815
States and Political Subdivisions	6,621	-	32	6,589	6,996	-	41	6,955
Mortgage-Backed Securities	180,019	165	3,050	177,134	111,427	22	1,212	110,237
Total	$236,764	$ 165	$ 3,750	$233,179	$216,679	$ 22	$ 1,694	$215,007
Total Investment Securities	$734,315	$ 892	$ 8,366	$726,841	$699,727	$ 834	$ 4,643	$695,918

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

Securities with an amortized cost of $247.1 million and $328.1 million at June 30, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and for other purposes.

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

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

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

	Available for Sale		**Held to Maturity**	
(Dollars in Thousands)	**Amortized Cost**	**Market Value**	**Amortized Cost**	**Market Value**
Due in one year or less	$ 92,474	$ 92,106	$ 16,635	$ 16,617
Due after one year through five years	264,809	260,934	40,110	39,428
Mortgage-Backed Securities	940	998	180,019	177,134
U.S. Government Agency	131,442	131,738	-	-
Equity Securities	7,886	7,886	-	-
Total	$ 497,551	$ 493,662	$ 236,764	$ 233,179

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

	Less Than 12 Months		Greater Than 12 Months		Total	
(Dollars in Thousands)	**Market Value**	**Unrealized Losses**	**Market Value**	**Unrealized Losses**	**Market Value**	**Unrealized Losses**
June 30, 2018						
Available for Sale						
U.S. Government Treasury	$ 146,449	$ 2,127	$ 97,386	$ 1,618	$243,835	$ 3,745
U.S. Government Agency	67,628	377	25,212	276	92,840	653
States and Political Subdivisions	54,511	176	5,079	42	59,590	218
Mortgage-Backed Securities	2	-	-	-	2	-
Total	268,590	2,680	127,677	1,936	396,267	4,616
Held to Maturity						
U.S. Government Treasury	24,574	489	24,882	179	49,456	668
States and Political Subdivisions	6,093	25	496	7	6,589	32
Mortgage-Backed Securities	108,323	1,742	29,894	1,308	138,217	3,050
Total	$ 138,990	$ 2,256	$ 55,272	$ 1,494	$194,262	$ 3,750
December 31, 2017						
Available for Sale						
U.S. Government Treasury	$ 155,443	$ 963	$ 79,900	$ 1,201	$235,343	$ 2,164
U.S. Government Agency	45,737	150	25,757	257	71,494	407
States and Political Subdivisions	82,999	320	5,549	58	88,548	378
Mortgage-Backed Securities	2	-	-	-	2	-
Total	284,181	1,433	111,206	1,516	395,387	2,949
Held to Maturity						
U.S. Government Treasury	77,861	298	14,939	143	92,800	441
States and Political Subdivisions	6,955	41	-	-	6,955	41
Mortgage-Backed Securities	56,030	469	30,216	743	86,246	1,212
Total	$ 140,846	$ 808	$ 45,155	$ 886	$186,001	$ 1,694

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

At June 30, 2018, there were 535 positions (combined AFS and HTM) with unrealized losses totaling $8.4 million. 61 of these positions were U.S. government treasury securities guaranteed by the U.S. government. 276 of these positions were U.S. government agency and mortgage-backed securities issued by U.S. government sponsored entities, with the remaining 198 positions being municipal securities. Because the declines in the market value of these securities are attributable to changes in interest rates and not credit quality and because the Company has the present ability and intent to hold these investments until there is a recovery in fair value, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2018.

NOTE 3 – LOANS, NET

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

(Dollars in Thousands)	**June 30, 2018**	**December 31, 2017**
Commercial, Financial and Agricultural	$ 222,406	$ 218,166
Real Estate – Construction	88,169	77,966
Real Estate – Commercial Mortgage	575,993	535,707
Real Estate – Residential[(1)]	331,944	311,906
Real Estate – Home Equity	218,851	229,513
Consumer[(2)]	287,112	280,234
Loans, Net of Unearned Income	$ 1,724,475	$ 1,653,492

(1) *Includes loans in process with outstanding balances of $15.9 million and $9.1 million at June 30, 2018 and December 31, 2017, respectively.*

(2) *Includes overdraft balances of $1.5 million and $1.6 million at June 30, 2018 and December 31, 2017, respectively.*

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

The Company has pledged a blanket floating lien on all 1-4 family residential mortgage loans, commercial real estate mortgage loans, and home equity loans to support available borrowing capacity at the FHLB and has pledged a blanket floating lien on all consumer loans, commercial loans, and construction loans to support available borrowing capacity at the Federal Reserve Bank of Atlanta.

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

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

	June 30, 2018		December 31, 2017	
(Dollars in Thousands)	**Nonaccrual**	**90 + Days**	**Nonaccrual**	**90 + Days**
Commercial, Financial and Agricultural	$ 455	$ -	$ 629	$ -
Real Estate – Construction	609	-	297	-
Real Estate – Commercial Mortgage	2,181	-	2,370	-
Real Estate – Residential	1,543	-	1,938	-
Real Estate – Home Equity	910	-	1,748	-
Consumer	43	-	177	36
Total Nonaccrual Loans	$ 5,741	$ -	$ 7,159	$ 36

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

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

(Dollars in Thousands)	**30-59 DPD**	**60-89 DPD**	**90 + DPD**	**Total Past Due**	**Total Current**	**Total Loans[(1)]**
June 30, 2018						
Commercial, Financial and Agricultural	$ 204	$ 113	$ -	$ 317	$ 221,634	$ 222,406
Real Estate – Construction	62	-	-	62	87,498	88,169
Real Estate – Commercial Mortgage	483	189	-	672	573,140	575,993
Real Estate – Residential	495	391	-	886	329,515	331,944
Real Estate – Home Equity	255	-	-	255	217,686	218,851
Consumer	1,009	271	-	1,280	285,789	287,112
Total Past Due Loans	$ 2,508	$ 964	$ -	$ 3,472	$ 1,715,262	$ 1,724,475
December 31, 2017						
Commercial, Financial and Agricultural	$ 87	$ 55	$ -	$ 142	$ 217,395	$ 218,166
Real Estate – Construction	811	-	-	811	76,858	77,966
Real Estate – Commercial Mortgage	437	195	-	632	532,705	535,707
Real Estate – Residential	701	446	-	1,147	308,821	311,906
Real Estate – Home Equity	80	2	-	82	227,683	229,513
Consumer	1,316	413	36	1,765	278,292	280,234
Total Past Due Loans	$ 3,432	$ 1,111	$ 36	$ 4,579	$ 1,641,754	$ 1,653,492

(1) Total Loans include nonaccrual loans

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

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

(Dollars in Thousands)	**Commercial, Financial, Agricultural**	**Real Estate Construction**	**Real Estate Commercial Mortgage**	**Real Estate Residential**	**Real Estate Home Equity**	**Consumer**	**Total**
Three Months Ended June 30, 2018							
Beginning Balance	$ 1,131	$ 244	$ 4,053	$ 3,363	$ 2,319	$ 2,148	$ 13,258
Provision for Loan Losses	137	39	364	(107)	110	272	815
Charge-Offs	(141)	-	-	(456)	(157)	(509)	(1,263)
Recoveries	87	-	15	346	22	283	753
Net Charge-Offs	(54)	-	15	(110)	(135)	(226)	(510)
Ending Balance	$ 1,214	$ 283	$ 4,432	$ 3,146	$ 2,294	$ 2,194	$ 13,563
Six Months Ended June 30, 2018							
Beginning Balance	$ 1,191	$ 122	$ 4,346	$ 3,206	$ 2,506	$ 1,936	$ 13,307
Provision for Loan Losses	93	167	238	73	20	969	1,560
Charge-Offs	(323)	(7)	(290)	(563)	(315)	(1,204)	(2,702)
Recoveries	253	1	138	430	83	493	1,398
Net Charge-Offs	(70)	(6)	(152)	(133)	(232)	(711)	(1,304)
Ending Balance	$ 1,214	$ 283	$ 4,432	$ 3,146	$ 2,294	$ 2,194	$ 13,563
Three Months Ended June 30, 2017							
Beginning Balance	$ 1,150	$ 100	$ 4,080	$ 3,376	$ 2,522	$ 2,107	$ 13,335
Provision for Loan Losses	229	14	165	(150)	(37)	368	589
Charge-Offs	(324)	-	(478)	(44)	-	(537)	(1,383)
Recoveries	40	-	58	202	39	362	701
Net Charge-Offs	(284)	-	(420)	158	39	(175)	(682)
Ending Balance	$ 1,095	$ 114	$ 3,825	$ 3,384	$ 2,524	$ 2,300	$ 13,242
Six Months Ended June 30, 2017							
Beginning Balance	$ 1,198	$ 168	$ 4,315	$ 3,445	$ 2,297	$ 2,008	$ 13,431
Provision for Loan Losses	193	(54)	(22)	(316)	251	847	899
Charge-Offs	(417)	-	(549)	(160)	(92)	(1,161)	(2,379)
Recoveries	121	-	81	415	68	606	1,291
Net Charge-Offs	(296)	-	(468)	255	(24)	(555)	(1,088)
Ending Balance	$ 1,095	$ 114	$ 3,825	$ 3,384	$ 2,524	$ 2,300	$ 13,242

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

(Dollars in Thousands	Commercial, Financial, Agricultural	Real Estate Construction	Real Estate Commercial Mortgage	Real Estate Residential	Real Estate Home Equity	Consumer	Total
June 30, 2018							
Period-end amount Allocated to:							
Loans Individually Evaluated for Impairment	$ 195	$ 113	$ 1,735	$ 1,030	$ 365	$ 1	$ 3,439
Loans Collectively Evaluated for Impairment	1,019	170	2,697	2,116	1,929	2,193	10,124
Ending Balance	$ 1,214	$ 283	$ 4,432	$ 3,146	$ 2,294	$ 2,194	$ 13,563
December 31, 2017							
Period-end amount Allocated to:							
Loans Individually Evaluated for Impairment	$ 215	$ 1	$ 2,165	$ 1,220	$ 515	$ 1	$ 4,117
Loans Collectively Evaluated for Impairment	976	121	2,181	1,986	1,991	1,935	9,190
Ending Balance	$ 1,191	$ 122	$ 4,346	$ 3,206	$ 2,506	$ 1,936	$ 13,307
June 30, 2017							
Period-end amount Allocated to:							
Loans Individually Evaluated for Impairment	$ 82	$ 4	$ 1,685	$ 1,405	$ 408	$ 3	$ 3,587
Loans Collectively Evaluated for Impairment	1,013	110	2,140	1,979	2,116	2,297	9,655
Ending Balance	$ 1,095	$ 114	$ 3,825	$ 3,384	$ 2,524	$ 2,300	$ 13,242

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

(Dollars in Thousands)	**Commercial, Financial, Agricultural**	**Real Estate Construction**	**Real Estate Commercial Mortgage**	**Real Estate Residential**	**Real Estate Home Equity**	**Consumer**	**Total**
June 30, 2018							
Individually Evaluated for Impairment	$ 1,093	$ 671	$ 18,368	$ 11,416	$ 2,589	$ 95	$ 34,232
Collectively Evaluated for Impairment	221,313	87,498	557,625	320,528	216,262	287,017	1,690,243
Total	$ 222,406	$ 88,169	$ 575,993	$ 331,944	$ 218,851	$ 287,112	$1,724,475
December 31, 2017							
Individually Evaluated for Impairment	$ 1,378	$ 361	$ 19,280	$ 12,871	$ 3,332	$ 113	$ 37,335
Collectively Evaluated for Impairment	216,788	77,605	516,427	299,035	226,181	280,121	1,616,157
Total	$ 218,166	$ 77,966	$ 535,707	$ 311,906	$ 229,513	$ 280,234	$1,653,492
June 30, 2017							
Individually Evaluated for Impairment	$ 1,078	$ 363	$ 21,502	$ 14,879	$ 3,314	$ 140	$ 41,276
Collectively Evaluated for Impairment	212,466	66,968	497,638	304,250	227,681	270,917	1,579,920
Total	$ 213,544	$ 67,331	$ 519,140	$ 319,129	$ 230,995	$ 271,057	$1,621,196

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

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

(Dollars in Thousands)	Unpaid Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Related Allowance
June 30, 2018				
Commercial, Financial and Agricultural	$ 1,093	$ 110	$ 983	$ 195
Real Estate – Construction	671	-	671	113
Real Estate – Commercial Mortgage	18,368	2,023	16,345	1,735
Real Estate – Residential	11,416	1,813	9,603	1,030
Real Estate – Home Equity	2,589	977	1,612	365
Consumer	95	39	56	1
Total	$ 34,232	$ 4,962	$ 29,270	$ 3,439
December 31, 2017				
Commercial, Financial and Agricultural	$ 1,378	$ 118	$ 1,260	$ 215
Real Estate – Construction	361	297	64	1
Real Estate – Commercial Mortgage	19,280	1,763	17,517	2,165
Real Estate – Residential	12,871	1,516	11,355	1,220
Real Estate – Home Equity	3,332	1,157	2,175	515
Consumer	113	45	68	1
Total	$ 37,335	$ 4,896	$ 32,439	$ 4,117

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2018		2017		2018		2017	
(Dollars in Thousands)	Average Recorded Investment	Total Interest Income	Average Recorded Investment	Total Interest Income	Average Recorded Investment	Total Interest Income	Average Recorded Investment	Total Interest Income
Commercial, Financial and Agricultural	$ 1,188	$ 22	$ 1,158	$ 11	$ 1,251	$ 50	$ 1,119	$ 23
Real Estate – Construction	671	1	363	1	568	1	324	2
Real Estate – Commercial Mortgage	18,406	168	22,281	220	18,697	344	22,806	443
Real Estate – Residential	12,310	136	14,789	174	12,497	284	15,058	353
Real Estate – Home Equity	2,894	24	3,414	27	3,040	51	3,401	54
Consumer	102	2	142	2	106	4	153	4
Total	$ 35,571	$ 353	$ 42,147	$ 435	$ 36,159	$ 734	$ 42,861	$ 879

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

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

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

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

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

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

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

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

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

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

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

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

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

(Dollars in Thousands)	**Commercial, Financial, Agriculture**	**Real Estate**	**Consumer**	**Total Criticized Loans**
June 30, 2018				
Special Mention	$ 5,143	$ 12,187	$ 59	$ 17,389
Substandard	1,089	28,124	370	29,583
Doubtful	-	-	-	-
Total Criticized Loans	$ 6,232	$ 40,311	$ 429	$ 46,972
December 31, 2017				
Special Mention	$ 7,879	$ 13,324	$ 65	$ 21,268
Substandard	1,057	29,291	654	31,002
Doubtful	-	-	-	-
Total Criticized Loans	$ 8,936	$ 42,615	$ 719	$ 52,270

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

The following table presents loans classified as TDRs.

(Dollars in Thousands)	**June 30, 2018** Accruing	**June 30, 2018** Nonaccruing	**December 31, 2017** Accruing	**December 31, 2017** Nonaccruing
Commercial, Financial and Agricultural	$ 666	$ 224	$ 822	$ -
Real Estate – Construction	62	-	64	-
Real Estate – Commercial Mortgage	16,282	1,250	17,058	1,636
Real Estate – Residential	10,571	631	11,666	503
Real Estate – Home Equity	2,305	99	2,441	186
Consumer	95	-	113	-
Total TDRs	$ 29,981	$ 2,204	$ 32,164	$ 2,325

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

	Three Months Ended June 30, 2018			**Six Months Ended June 30, 2018**		
(Dollars in Thousands)	**Number of Contracts**	**Pre-Modified Recorded Investment**	**Post-Modified Recorded Investment**	**Number of Contracts**	**Pre-Modified Recorded Investment**	**Post-Modified Recorded Investment**
Commercial, Financial and Agricultural	-	$ -	$ -	1	$ 498	$ 230
Real Estate – Construction	-	-	-	-	-	-
Real Estate – Commercial Mortgage	-	-	-	1	227	227
Real Estate – Residential	1	33	33	1	33	33
Real Estate – Home Equity	1	27	27	1	27	27
Consumer	-	-	-	-	-	-
Total TDRs	2	$ 60	$ 60	4	$ 785	$ 517

	Three Months Ended June 30, 2017			**Six Months Ended June 30, 2017**		
(Dollars in Thousands)	**Number of Contracts**	**Pre-Modified Recorded Investment**	**Post-Modified Recorded Investment**	**Number of Contracts**	**Pre-Modified Recorded Investment**	**Post-Modified Recorded Investment**
Commercial, Financial and Agricultural	-	$ -	$ -	-	$ -	$ -
Real Estate – Construction	-	-	-	1	64	65
Real Estate – Commercial Mortgage	-	-	-	-	-	-
Real Estate – Residential	1	215	182	1	215	182
Real Estate – Home Equity	-	-	-	1	56	55
Consumer	-	-	-	-	-	-
Total TDRs	1	$ 215	$ 182	3	$ 335	$ 302

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

	Three Months Ended June 30, 2018		**Six Months Ended June 30, 2018**	
(Dollars in Thousands)	**Number of Contracts**	**Post-Modified Recorded Investment[1]**	**Number of Contracts**	**Post-Modified Recorded Investment[1]**
Commercial, Financial and Agricultural	-	$ -	-	$ -
Real Estate – Construction	-	-	-	-
Real Estate – Commercial Mortgage	1	64	1	64
Real Estate – Residential	-	-	-	-
Real Estate – Home Equity	-	-	-	-
Consumer	-	-	-	-
Total TDRs	1	$ 64	1	$ 64

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

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

	Three Months Ended June 30, 2018		**Six Months Ended June 30, 2018**	
(Dollars in Thousands)	Number of Contracts	Recorded Investment[1]	Number of Contracts	Recorded Investment[1]
Extended amortization	-	$ -	1	$ 227
Interest rate adjustment	1	33	1	33
Extended amortization and interest rate adjustment	1	27	1	27
Principal moratorium	-	-	1	230
Total TDRs	2	$ 60	4	$ 517

	Three Months Ended June 30, 2017		**Six Months Ended June 30, 2017**	
(Dollars in Thousands)	Number of Contracts	Recorded Investment[1]	Number of Contracts	Recorded Investment[1]
Extended amortization	-	$ -	-	$ -
Interest rate adjustment	1	182	3	302
Extended amortization and interest rate adjustment	-	-	-	-
Total TDRs	1	$ 182	3	$ 302

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

NOTE 4 – OTHER REAL ESTATE OWNED

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in Thousands)	**2018**	**2017**	**2018**	**2017**
Beginning Balance	$ 3,330	$ 9,501	$ 3,941	$ 10,638
Additions	533	144	840	1,685
Valuation Write-downs	(138)	(275)	(632)	(769)
Sales	(352)	(1,209)	(776)	(3,320)
Other	-	(193)	-	(266)
Ending Balance	$ 3,373	$ 7,968	$ 3,373	$ 7,968

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in Thousands)	**2018**	**2017**	**2018**	**2017**
Gains from the Sale of Properties	$ (53)	$ (162)	$ (81)	$ (268)
Losses from the Sale of Properties	54	93	142	195
Rental Income from Properties	(3)	(22)	(6)	(54)
Property Carrying Costs	112	131	187	257
Valuation Adjustments	138	275	632	768
Total	$ 248	$ 315	$ 874	$ 898

As of June 30, 2018, the Company had $1.5 million of loans secured by residential real estate in the process of foreclosure**.**

NOTE 5 - EMPLOYEE BENEFIT PLANS

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in Thousands)	**2018**	**2017**	**2018**	**2017**
Service Cost	$ 1,721	$ 1,688	$ 3,442	$ 3,376
Interest Cost	1,415	1,437	2,830	2,874
Expected Return on Plan Assets	(2,391)	(2,006)	(4,782)	(4,012)
Prior Service Cost Amortization	50	56	100	112
Net Loss Amortization	918	953	1,837	1,906
Net Periodic Benefit Cost	$ 1,713	$ 2,128	$ 3,427	$ 4,256
Discount Rate	3.71%	4.21%	3.71%	4.21%
Long-term Rate of Return on Assets	7.25%	7.25%	7.25%	7.25%

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in Thousands)	**2018**	**2017**	**2018**	**2017**
Interest Cost	$ 57	$ 48	$ 113	$ 96
Net Loss Amortization	406	149	813	298
Net Periodic Benefit Cost	$ 463	$ 197	$ 926	$ 394
Discount Rate	3.53%	3.92%	3.53%	3.92%

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

During the first six months of 2018, the Company contributed $20 million (first quarter - $10 million, second quarter - $10 million) to its defined benefit pension plan for the 2017 plan year.

NOTE 6 - COMMITMENTS AND CONTINGENCIES

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

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

	June 30, 2018			**December 31, 2017**		
(Dollars in Thousands)	**Fixed**	**Variable**	**Total**	**Fixed**	**Variable**	**Total**
Commitments to Extend Credit [1]	$ 87,183	$ 388,016	$ 475,199	$ 78,390	$ 366,750	$ 445,140
Standby Letters of Credit	4,722	-	4,722	4,678	-	4,678
Total	$ 91,905	$ 388,016	$ 479,921	$ 83,068	$ 366,750	$ 449,818

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

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

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

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

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

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

In June 2018, Visa increased the litigation reserve by $600 million and revised the conversion ratio for the Class B shares resulting in a $0.2 million payable due the counterparty under the swap contract. Fixed charges included in the swap liability are payable quarterly until the litigation reserve is fully liquidated and at which time the aforementioned swap contract will be terminated. Quarterly fixed payments approximate $119,000. Conversion ratio payments and ongoing fixed quarterly charges are reflected in earnings in the period incurred.

NOTE 7 – FAIR VALUE MEASUREMENTS

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

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

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Securities Available for Sale. U.S. Treasury securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the

Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, credit information and the bond’s terms and conditions, among other things.

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

Fair Value Swap. The Company entered into a stand-alone derivative contract with the purchaser of its Visa Class B shares. The valuation represents the amount due and payable to the counterparty based upon the revised share conversion rate, if any, during the period. At June 30, 2018, there was $0.2 million payable to the counterparty.

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

(Dollars in Thousands)	**Level 1 Inputs**	**Level 2 Inputs**	**Level 3 Inputs**	**Total Fair Value**
June 30, 2018				
ASSETS:				
Securities Available for Sale:				
U.S. Government Treasury	$ 258,738	$ -	$ -	$ 258,738
U.S. Government Agency	-	159,909	-	159,909
States and Political Subdivisions	-	66,131	-	66,131
Mortgage-Backed Securities	-	998	-	998
Equity Securities	-	7,886	-	7,886
LIABILITIES:				
Fair Value Swap	-	-	220	220
December 31, 2017				
ASSETS:				
Securities Available for Sale:				
U.S. Government Treasury	$ 235,341	$ -	$ -	$ 235,341
U.S. Government Agency	-	144,644	-	144,644
States and Political Subdivisions	-	91,157	-	91,157
Mortgage-Backed Securities	-	1,185	-	1,185
Equity Securities	-	8,584	-	8,584

Assets Measured at Fair Value on a Non-Recurring Basis

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

Impaired Loans. Impairment for collateral dependent loans is measured using the fair value of the collateral less selling costs. The fair value of collateral is determined by an independent valuation or professional appraisal in conformance with banking regulations. Collateral values are estimated using Level 3 inputs due to the volatility in the real estate market, and the judgment and estimation involved in the real estate appraisal process. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly. Valuation techniques are consistent with those techniques applied in prior periods. Impaired collateral dependent loans had a carrying value of $4.8 million with a valuation allowance of $0.7 million at June 30, 2018 and $6.1 million and $1.1 million, respectively, at December 31, 2017.

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

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

Assets and Liabilities Disclosed at Fair Value

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

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

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

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

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

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

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

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

	June 30, 2018			
(Dollars in Thousands)	**Carrying Value**	**Level 1 Inputs**	**Level 2 Inputs**	**Level 3 Inputs**
ASSETS:				
Cash	$ 56,573	$ 56,573	$ -	$ -
Short-Term Investments	107,066	107,066	-	-
Investment Securities, Available for Sale	493,662	258,738	234,924	-
Investment Securities, Held to Maturity	236,764	49,456	183,723	-
Equity Securities(1)	3,600	-	3,600	-
Loans Held for Sale	8,246	-	8,246	-
Loans, Net of Allowance for Loan Losses	1,710,912	-	-	1,675,884
LIABILITIES:				
Deposits	$ 2,459,190	$ -	$ 2,457,218	$ -
Short-Term Borrowings	7,021	-	7,021	-
Subordinated Notes Payable	52,887	-	42,640	-

Long-Term Borrowings	12,897	-	12,903	-

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

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

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

NOTE 8 – OTHER COMPREHENSIVE INCOME

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

(Dollars in Thousands)	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Three Months Ended June 30, 2018			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	$ (265)	$ 67	$ (198)
Amortization of losses on securities transferred from available for sale to held to maturity	14	(4)	10
Total Other Comprehensive Loss	$ (251)	$ 63	$ (188)
Six Months Ended June 30, 2018			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	$ (1,752)	$ 443	$ (1,309)
Amortization of losses on securities transferred from available for sale to held to maturity	28	(7)	21
Total Other Comprehensive Loss	$ (1,724)	$ 436	$ (1,288)

(Dollars in Thousands)	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Three Months Ended June 30, 2017			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	$ 110	$ (42)	$ 68
Amortization of losses on securities transferred from available for sale to held to maturity	18	(7)	11
Total Other Comprehensive Income	$ 128	$ (49)	$ 79
Six Months Ended June 30, 2017			

Investment Securities:						
Change in net unrealized gain/loss on securities available for sale	$	615	$	(238)	$	377
Amortization of losses on securities transferred from available for sale to held to maturity		38		(15)		23
Total Other Comprehensive Income	$	653	$	(253)	$	400

Accumulated other comprehensive loss was comprised of the following components:

(Dollars in Thousands)	**Securities Available for Sale**	**Retirement Plans**	**Accumulated Other Comprehensive Loss**
Balance as of January 1, 2018	$ (1,743)	$ (30,301)	$ (32,044)
Other comprehensive loss during the period	(1,288)	-	(1,288)
Balance as of June 30, 2018	$ (3,031)	$ (30,301)	$ (33,332)
Balance as of January 1, 2017	$ (583)	$ (25,642)	$ (26,225)
Other comprehensive income during the period	400	-	400
Balance as of June 30, 2017	$ (183)	$ (25,642)	$ (25,825)

NOTE 9 – ACCOUNTING STANDARDS UPDATES

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

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

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

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

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

Management’s discussion and analysis ("MD&A") provides supplemental information, which sets forth the major factors that have affected our financial condition and results of operations and should be read in conjunction with the Consolidated Financial Statements and related notes. The following information should provide a better understanding of the major factors and trends that affect our earnings performance and financial condition, and how our performance during 2018 compares with prior years. Throughout this section, Capital City Bank Group, Inc., and subsidiaries, collectively, is referred to as "CCBG," "Company," "we," "us," or "our."

CAUTION CONCERNING FORWARD-LOOKING STATEMENTS

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

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

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

BUSINESS OVERVIEW

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

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

A detailed discussion regarding the economic conditions in our markets and our long-term strategic objectives is included as part of the MD&A section of our 2017 Form 10-K.

NON-GAAP FINANCIAL MEASURE

We present a tangible common equity ratio that removes the effect of goodwill resulting from merger and acquisition activity. We believe this measure is useful to investors because it allows investors to more easily compare our capital adequacy to other companies in the industry. The GAAP to non-GAAP reconciliation is provided below.

		2018		2017			
(Dollars in Thousands)		Second	First	Fourth	Third	Second	
Shareowners' Equity (GAAP)		$ 293,571	$ 288,360	$ 284,210	$ 285,201	$ 281,513	$
Less: Goodwill (GAAP)		84,811	84,811	84,811	84,811	84,811	
Tangible Shareowners' Equity (non-GAAP)	A	208,760	203,549	199,399	200,390	196,702	
Total Assets (GAAP)		2,880,278	2,924,832	2,898,794	2,790,842	2,814,843	2
Less: Goodwill (GAAP)		84,811	84,811	84,811	84,811	84,811	
Tangible Assets (non-GAAP)	B	$ 2,795,467	$ 2,840,021	$ 2,813,983	$ 2,706,031	$ 2,730,032	$ 2
Tangible Common Equity Ratio (non-GAAP)	A/B	7.47%	7.17%	7.09%	7.41%	7.21%	
Actual Diluted Shares Outstanding (GAAP)	C	17,114,380	17,088,419	17,071,107	17,045,326	17,025,148	16
Diluted Tangible Book Value (non-GAAP)	A/C	12.20	11.91	11.68	11.76	11.55	

SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

(Dollars in Thousands, Except	**2018**		**2017**				
(Per Share Data)	Second	First	Fourth	Third	Second	First	
Summary of Operations:							
Interest Income	$ 24,419	$ 23,214	$ 22,627	$ 22,341	$ 21,422	$ 20,540	$
Interest Expense	1,649	1,451	1,138	1,080	926	804	
Net Interest Income	22,770	21,763	21,489	21,261	20,496	19,736	
Provision for Loan Losses	815	745	826	490	589	310	
Net Interest Income After Provision for Loan Losses	21,955	21,018	20,663	20,771	19,907	19,426	
Noninterest Income	12,542	12,477	12,897	12,996	13,135	12,718	
Noninterest Expense	28,393	27,906	26,897	26,707	27,921	27,922	
Income Before Income Taxes	6,104	5,589	6,663	7,060	5,121	4,222	
Income Tax Expense (Benefit)(2)	101	(184)	6,660	2,505	1,560	1,478	
Net Income	6,003	5,773	3	4,555	3,561	2,744	
Net Interest Income (FTE)	$ 22,917	$ 21,943	$ 21,808	$ 21,595	$ 20,799	$ 20,006	$
Per Common Share:							
Net Income Basic	$ 0.35	$ 0.34	$ 0.00	$ 0.27	$ 0.21	$ 0.16	$
Net Income Diluted	0.35	0.34	0.00	0.27	0.21	0.16	
Cash Dividends Declared	0.07	0.07	0.07	0.07	0.05	0.05	
Diluted Book Value	17.15	16.87	16.65	16.73	16.54	16.38	
Diluted Tangible Book Value(1)	12.20	11.91	11.68	11.76	11.55	11.38	
Market Price:							
High	25.99	26.50	26.01	24.58	22.39	21.79	
Low	22.28	22.80	22.21	19.60	17.68	19.22	
Close	23.63	24.75	22.94	24.01	20.42	21.39	
Selected Average Balances:							
Loans, Net	$1,691,287	$1,647,612	$1,640,738	$1,638,578	$1,608,629	$1,585,561	$
Earning Assets	2,566,006	2,592,465	2,511,985	2,466,287	2,502,030	2,529,207	
Total Assets	2,861,104	2,892,120	2,822,451	2,779,960	2,817,479	2,845,140	
Deposits	2,431,956	2,456,106	2,378,411	2,329,162	2,373,423	2,407,278	
Shareowners' Equity	291,806	287,502	288,044	285,296	281,661	278,489	
Common Equivalent Average Shares:							
Basic	17,045	17,028	16,967	16,965	16,955	16,919	
Diluted	17,104	17,073	17,050	17,044	17,016	16,944	
Performance Ratios:							
Return on Average Assets	0.84%	0.81%	0.00%	0.65%	0.51%	0.39%	
Return on Average Equity	8.25	8.14	0.00	6.33	5.07	4.00	
Net Interest Margin (FTE)	3.58	3.43	3.45	3.48	3.33	3.21	
Noninterest Income as % of Operating Revenue	35.52	36.44	37.51	37.94	39.05	39.19	
Efficiency Ratio	80.07	81.07	77.50	77.21	82.28	85.33	

Asset Quality:							
Allowance for Loan Losses	$ 13,563	$ 13,258	$ 13,307	$ 13,339	$ 13,242	$ 13,335	$
Allowance for Loan Losses to Loans	0.78%	0.80%	0.80%	0.82%	0.81%	0.84%	
Nonperforming Assets ("NPAs")	9,114	10,644	11,100	12,545	15,934	17,799	
NPAs to Total Assets	0.32	0.36	0.38	0.45	0.57	0.61	
NPAs to Loans plus OREO	0.52	0.64	0.67	0.76	0.97	1.11	
Allowance to Non-Performing Loans	236.25	181.26	185.87	203.39	166.23	160.70	
Net Charge-Offs to Average Loans	0.12	0.20	0.21	0.10	0.17	0.10	
Capital Ratios:							
Tier 1 Capital	16.25%	16.31%	16.33%	16.19%	15.58%	15.68%	
Total Capital	17.00	17.05	17.10	16.96	16.32	16.44	
Common Equity Tier 1	13.46	13.44	13.42	13.26	12.72	12.77	
Leverage	10.69	10.36	10.47	10.48	10.20	9.95	
Tangible Common Equity[1]	7.47	7.17	7.09	7.41	7.21	6.88	

[1]*Non-GAAP financial measure. See non-GAAP reconciliation on page 30.*

[2]*Includes $1.4 million and $1.5 million income tax benefit in the second and first quarter of 2018, respectively, related to tw plan contributions. Also, a $4.1 million income tax expense adjustment in the fourth quarter, 2017 related to the Tax Cuts and Jobs act of 2017.*

FINANCIAL OVERVIEW

A summary overview of our financial performance is provided below.

Results of Operations

- Net income of $6.0 million, or $0.35 per diluted share, for the second quarter of 2018 compared to net income of $5.8 million, or $0.34 per diluted share, for the first quarter of 2018, and net income of $3.6 million, or $0.21 per diluted share for the second quarter of 2017. For the first six months of 2018, we realized net income of $11.8 million, or $0.69 per diluted share, compared to net income of $6.3 million, or $0.37 per diluted share, for the same period of 2017.

- Tax equivalent net interest income for the second quarter of 2018 was $22.9 million compared to $21.9 million for the first quarter of 2018 and $20.8 million for the second quarter of 2017. For the first six months of 2018, tax equivalent net interest income totaled $44.9 million compared to $40.8 million for the comparable period of 2017. The increase compared to all prior periods reflected higher interest rates and a favorable shift in the earning asset mix. Higher rates earned on overnight funds, investment securities, and variable rate loans were partially offset by a higher cost on our negotiated rate deposits.

- Provision for loan losses was $0.8 million for the second quarter of 2018 compared to $0.8 million for the first quarter of 2018 and $0.6 million for the second quarter of 2017. For the first six months of 2018, the loan loss provision totaled $1.6 million compared to $0.9 million for the same period of 2017. The higher provision in 2018 reflected growth in the loan portfolio.

- Noninterest income for the second quarter of 2018 totaled $12.5 million, an increase of $0.1 million, or 0.5%, over the first quarter of 2018 and a $0.6 million, or 4.5%, decrease from the second quarter of 2017. For the first six months of 2018, noninterest income totaled $25.0 million, a $0.8 million, or 3.2%, decrease from the same period of 2017. The decrease from both prior year periods was primarily attributable to lower mortgage banking fees and deposit fees.

- Noninterest expense for the second quarter of 2018 totaled $28.4 million, an increase of $0.5 million, or 1.7%, over the first quarter of 2018 and the second quarter of 2017. For the first six months of 2018, noninterest expense totaled $56.3 million, an increase of $0.5 million, or 0.8%, over the same period of 2017. The increase over all prior periods was primarily due to higher professional fees as well as a non-routine expense for our VISA Class B share swap contract related to VISA's funding of their litigation reserve.

Financial Condition

- Average earning assets were $2.566 billion for the second quarter of 2018, a decrease of $26.5 million, or 1.0%, from the first quarter of 2018, and an increase of $54.0 million, or 2.2%, over the fourth quarter of 2017. The change in average earning assets compared to the first quarter 2018 was attributable to decreases in our short-term investments, primarily due to a decline in our seasonal public fund balances. The change in average earning assets over the fourth quarter 2017 was attributable to growth in our loan and investment portfolios primarily funded by increases in our noninterest bearing deposits and savings accounts.

- Average loans increased by $43.7 million, or 2.7%, over the first quarter of 2018, and $50.5 million, or 3.1%, over the fourth quarter of 2017. The increase compared to the first quarter of 2018 reflected growth in all loans types except home equity loans. Growth over the fourth quarter of 2017 was experienced in all loan products except for commercial and home equity loans.

- Nonperforming assets totaled $9.1 million at June 30, 2018, a decrease of $1.5 million, or 14.4%, from March 31, 2018 and $2.0 million, or 17.9%, from December 31, 2017. Nonperforming assets represented 0.32% of total assets at June 30, 2018 compared to 0.36% at March 31, 2018 and 0.38% at December 31, 2017.

- At June 30, 2018, we were well-capitalized with a risk based capital ratio of 17.00% and a tangible common equity ratio of 7.47% compared to 17.05% and 7.17%, respectively, at March 31, 2018, and 17.10% and 7.09%, respectively, at December 31, 2017. All of our regulatory capital ratios exceeded the threshold to be well-capitalized under the Basel III capital standards.

RESULTS OF OPERATIONS

Net Income

For the second quarter of 2018, we realized net income of $6.0 million, or $0.35 per diluted share, compared to net income of $5.8 million, or $0.34 per diluted share for the first quarter of 2018, and net income of $3.6 million, or $0.21 per diluted share, for the second quarter of 2017. For the first six months of 2018, we realized net income of $11.8 million, or $0.69 per diluted share, compared to net income of $6.3 million, or $0.37 per diluted share for the same period of 2017.

Net income for the first six months of 2018 included tax benefits totaling $2.9 million, or $0.17 per diluted share (1Q - $1.5 million, or $0.09 per diluted share and 2Q - $1.4 million, or $0.08 per diluted share) related to 2017 plan year pension plan contributions.

Compared to the first quarter of 2018, the $0.5 million increase in operating profit reflected a $1.0 million increase in net interest income and higher noninterest income of $0.1 million, partially offset by higher noninterest expense of $0.5 million and a $0.1 million increase in the loan loss provision.

Compared to the second quarter of 2017, the $1.0 million increase in operating profit was attributable to higher net interest income of $2.3 million, partially offset by lower noninterest income of $0.6 million, a $ 0.5 million increase in noninterest expense, and a $0.2 million increase in the loan loss provision.

The increase in operating profit for the first six months of 2018 versus the comparable period of 2017 was attributable to higher net interest income of $4.3 million that was partially offset by lower noninterest income of $0.8 million, higher noninterest expense of $0.5 million, and $0.7 million increase in the loan loss provision.

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

	Three Months Ended			**Six Months Ended**	
(Dollars in Thousands, except per share data)	**June 30, 2018**	**March 31, 2018**	**June 30, 2017**	**June 30, 2018**	**June 30, 2017**
Interest Income	$ 24,419	$ 23,214	$ 21,422	$ 47,633	$ 41,962
Taxable Equivalent Adjustments	147	180	303	327	573
Total Interest Income (FTE)	24,566	23,394	21,725	47,960	42,535
Interest Expense	1,649	1,451	926	3,100	1,730
Net Interest Income (FTE)	22,917	21,943	20,799	44,860	40,805
Provision for Loan Losses	815	745	589	1,560	899
Taxable Equivalent Adjustments	147	180	303	327	573
Net Interest Income After Provision for Loan Losses	21,955	21,018	19,907	42,973	39,333
Noninterest Income	12,542	12,477	13,135	25,019	25,853
Noninterest Expense	28,393	27,906	27,921	56,299	55,843
Income Before Income Taxes	6,104	5,589	5,121	11,693	9,343
Income Tax Expense (Benefit)	101	(184)	1,560	(83)	3,038
Net Income	$ 6,003	$ 5,773	$ 3,561	$ 11,776	$ 6,305
Basic Net Income Per Share	$ 0.35	$ 0.34	$ 0.21	$ 0.69	$ 0.37
Diluted Net Income Per Share	$ 0.35	$ 0.34	$ 0.21	$ 0.69	$ 0.37

Net Interest Income

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

Tax-equivalent net interest income was $22.9 million for the second quarter of 2018 compared to $21.9 million for the first quarter of 2018 and $20.8 million for the second quarter of 2017. For the first six months of 2018, tax equivalent net interest income totaled $44.9 million compared to $40.8 million for the comparable period of 2017. The increase in tax-equivalent net interest income compared to all prior periods reflected growth in the loan and investment portfolios, coupled with higher short-term rates, partially offset by higher rates paid on negotiated rate deposits.

The federal funds target rate was increased seven times since December 2015 to 2.00% as of the end of the second quarter of 2018, which positively affected our net interest income due to favorable repricing of our variable and adjustable rate earning assets. Although these increases have also resulted in higher rates paid on our negotiated rate deposit products, we continue to prudently manage our overall cost of funds, which was 26 basis points for the second quarter of 2018 and 24 basis points for the first six months of 2018. Due to highly competitive fixed-rate loan pricing across most markets, we have continued to review our loan pricing and make adjustments where appropriate and prudent.

Our net interest margin for the second quarter of 2018 was 3.58%, an increase of 15 basis points over the first quarter of 2018 and an increase of 25 basis points over the second quarter of 2017. For the first six months of 2018, the net interest margin increased 24 basis points to 3.51% compared to the same period of 2017. The increase in the margin as compared to all prior periods reflected rising interest rates and a favorable shift in our earning asset mix, which has produced higher net interest income in each period.

We continue to maintain short duration portfolios on both sides of the balance sheet and believe we are well positioned to respond to changing market conditions.

Provision for Loan Losses

The provision for loan losses for the second quarter of 2018 was $0.8 million compared to $0.8 million provision expense for the first quarter of 2018 and $0.6 million for the second quarter of 2017. For the first six months of 2018, the loan loss provision was $1.6 million compared to $0.9 million for the same period of 2017. The higher provision in 2018 reflected growth in the loan portfolio. We realized net loan charge-offs of $0.5 million, or 0.12% (annualized), of average loans for the second quarter of 2018. This compares to net loan charge-offs of $0.8 million, or 0.20% (annualized) for the first quarter of 2018 and net charge-offs of $0.7 million, or 0.17% (annualized) for the second quarter of 2017. For the first six months of 2018, net charge-offs totaled $1.3 million, or 0.16% (annualized), of average loans compared to $1.1 million, or 0.14% (annualized), for the same period of 2017.

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

	Three Months Ended			Six Months Ended	
(Dollars in Thousands, except per share data)	June 30, 2018	March 31, 2018	June 30, 2017	June 30, 2018	June 30, 2017
CHARGE-OFFS					
Commercial, Financial and Agricultural	$ 141	$ 182	$ 324	$ 323	$ 417
Real Estate - Construction	-	7	-	7	-
Real Estate - Commercial Mortgage	-	290	478	290	549
Real Estate - Residential	456	107	44	563	160
Real Estate - Home Equity	157	158	-	315	92
Consumer	509	695	537	1,204	1,161
Total Charge-offs	$ 1,263	$ 1,439	$ 1,383	$ 2,702	$ 2,379
RECOVERIES					
Commercial, Financial and Agricultural	$ 87	$ 166	$ 40	$ 253	$ 121
Real Estate - Construction	-	1	-	1	-
Real Estate - Commercial Mortgage	15	123	58	138	81
Real Estate - Residential	346	84	202	430	415
Real Estate - Home Equity	22	61	39	83	