



# Where Dedication *Meets* Innovation

Colony Bank | 2013 Annual Report





Photos above are actual clips from our recent commercial.

# VISION

Colony Bank strives to be a high performance community bank, providing shareholders with a fair return on their investment while improving the quality of life in the communities we serve.

# MISSION

Our mission can best be accomplished by applying sound banking principles in corporate decision-making and by providing our customers a degree of highly personalized, professional service that is unmatched in the market. **Service | Stability | Success**

# Dedication *Meets* Innovation

To achieve long-term success, every company must achieve optimum balance between efficiency and effectiveness, growth and excellence, results and relationships. With today's unprecedented velocity of change, that can be a tall order. Colony Bank has accepted and embraced this challenge with technology, responsiveness, choices and dedication.

In 2013 we developed and brought to market a Mobile Banking App, a Tablet App, eAlerts, Person-to-Person Payments (Popmoney®), Check Cashing Services and the Colony One account, designed for those needing a second chance.

As the business wheels turn for our commercial customers, we shifted into high gear to ensure we deliver

quality products quickly and easily. Our work illustrates the difference local service makes to our customers and their companies.

We work hard to provide and deliver a complete line of business products including commercial loans, business online banking, business bill pay, remote deposit capture, ACH manager and wire manager. We work hard at Colony to deliver the capacity and expertise of a large bank with the personal touch that only a community bank can offer.

## Dedication Meets Innovation

As a customer, you deserve both.

And as your bank, we'll deliver them.



## TABLE OF CONTENTS

Introduction.....	1
Letter to the Shareholders .....	2
Financial Summary .....	3

Board of Directors.....	4-5
Directors Emeritus .....	5
West and East Markets .....	6-7

How Colony Bank Puts Innovation to Work .....	8
Consolidated Financial Statements .....	9

## DEAR SHAREHOLDERS

2013 was a year of significant accomplishment for Colony Bank. South and Central Georgia showed improving trends in business activity, real estate values; and, once again, a healthy agribusiness environment. I would love to say growth in our markets was robust, but that would be a bit much. Stable and gradually improving is more appropriate and while not robust, 2013 was much improved over the economies of 2008-2012.

Colony Bank's accomplishments are evident in four critical areas. First, net income available to shareholders increased 158% from \$1,206,000 or \$.14 per diluted share in 2012 to \$3,120,000 or \$.37 per share in 2013. Second, our substandard assets to tier one capital plus loan loss allowance ratio (coverage ratio) improved from 55.60% on December 31, 2012 to 38.18% on December 31, 2013. Third, our commitment to technology and product development is improving our service delivery and making the operation more efficient. During the past year we committed to initiatives that will enhance communications, processing capacity, and customer service. We have installed a VoIP telephone system, committed to a new main frame computer, and replaced/upgraded over 75% of our ATMs. In addition, we created a mobile banking and tablet application and enhanced our small business online banking service. Other new products and services include LifeLock®, eAlerts, Popmoney® payments, "not on us" check cashing, and the

Colony One account designed for electronic payments only. When fully implemented, the savings generated through these investments will lower our related operating expense ratio and the new products and services will increase non-interest income. Last, but not least, the improvement in earnings and credit quality mentioned previously were the primary factors responsible for the removal of our memorandums of understanding with the Georgia Department of Banking and Finance and the Federal Deposit Insurance Corporation.

The banking industry in Georgia has endured a very difficult recession during the last five years. Over 80 banks in the state failed during that time. Colony Bank was aided by the TARP program with a \$28 million capital injection in 2009. This capital enabled Colony Bank to be a survivor of this recession and we remain focused on returning the earnings and credit quality of the company to acceptable standards. During 2014 the board is committed to surveying the capital options available to the company. Fortunately, we now have a variety of options.

Undoubtedly, 2014 will be a historic year on a variety of fronts. For banking the implementation of the Dodd Frank Act has created a focus on

compliance and mortgage lending that is both complex and expensive. We have made every effort to be prepared in this regard. Next, the implementation of the Affordable Care Act is having an impact on many of our customers and the long-term cost and impact is uncertain. The domestic economic forecast seems to be continued stability with sporadic growth. Internationally, economies continue to be in recovery, but with occasional political disruptions that cause concern. Hopefully, capable leadership will result in improved peace and prosperity both domestically and abroad.

The theme for the 2013 annual report is "Dedication to Innovation." Colony Bank remains dedicated to the customers and communities we serve; dedicated to being a positive influence in the lives of individuals that chose Colony Bank as a customer or employee. Colony Bank continues to staff our offices as a community bank and equip our staff with the tools and technology to compete in today's marketplace.

**As always the board of directors, officers and staff thank you for your continued support through the past year and going forward.** We believe the momentum created during 2013 will be evident in the results of 2014!



Edward P. Loomis, Jr.  
President and  
Chief Executive Officer



B. Gene Waldron  
Chairman of the Board

# FINANCIAL SUMMARY FOR COLONY BANK



**Edward P. Loomis, Jr.**  
*President and  
Chief Executive Officer*



**B. Gene Waldron**  
*Chairman of the Board*

## 2013 KEY PERFORMANCE INDICATORS

Years Ended December 31, 2013 and 2012

Dollar amounts in thousands except per share data	2013	2012	Percent Change
Total Assets	\$1,148,551	\$1,139,397	0.80%
Total Deposits	\$987,529	\$979,685	0.80%
Loans (Net of Unearned Income)	\$750,857	\$746,816	0.54%
Net Income	\$3,120	\$1,206	158.71%

### Per Share Data:

Basic Earnings	\$0.37	\$0.14	164.29%
Common Book Value/Share	\$7.34	\$8.05	(8.82)%

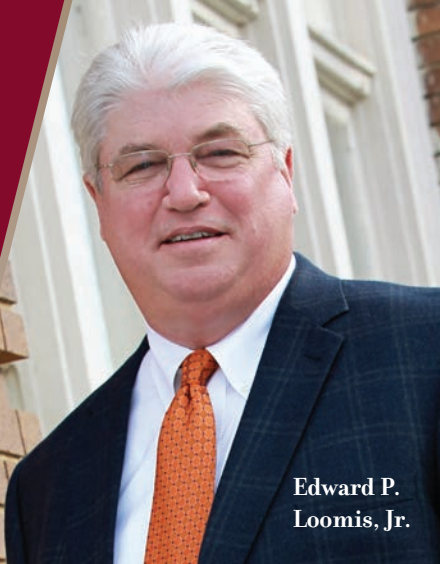
## KEY TRENDS

A Historical Comparative

Years Ending	2013	2012	2011	2010	2009
Net Income (in thousands)	\$3,120	\$1,206	\$1,133	\$(926)	\$(20,549)
Return on Average Shareholders' Equity	3.34%	1.25%	1.20%	(0.98)%	(19.45)%
Diluted Earnings Per Share	\$0.37	\$0.14	\$0.13	\$(0.11)	\$(2.85)

RETURN ON AVERAGE ASSETS	
2013	2012
0.28%	0.11%

NET INTEREST MARGIN	
2013	2012
3.61%	3.41%



Edward P.  
Loomis, Jr.



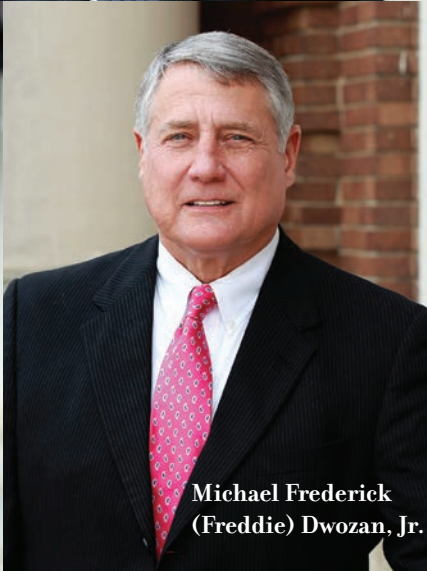
B. Gene Waldron



Mark H. Masee



Scott L. Downing



Michael Frederick  
(Freddie) Dwozan, Jr.



Edward J. Harrell



Terry L. Hester



Davis W. King, Jr.



Jonathan  
W. R. Ross

# BOARD OF DIRECTORS

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**Edward P. Loomis, Jr.**

*President / CEO*  
Colony Bankcorp, Inc.  
Fitzgerald, Georgia

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**B. Gene Waldron**

*Chairman*  
Colony Bankcorp, Inc.  
*President / CEO*  
Waldron Enterprises, Inc.  
Douglas, Georgia

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**Mark H. Masee**

*Vice Chairman*  
Colony Bankcorp, Inc.  
*President*  
Masee Builders, Inc.  
*Mayor of City of Fitzgerald*  
Fitzgerald, Georgia

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**Scott L. Downing**

*President*  
SDI Investments  
Fitzgerald, Georgia

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**Michael Frederick  
(Freddie) Dwozan, Jr.**

*President / CEO / Owner*  
Medical Center  
Prescription Shop  
Eastman, Georgia

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**Edward J. Harrell**

*Attorney, Managing Partner*  
Martin Snow, LLP  
Macon, Georgia

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**Terry L. Hester**

*EVP / CFO*  
Colony Bankcorp, Inc.  
Fitzgerald, Georgia

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**Davis W. King, Jr.**

*Chairman / President*  
King Enterprise &  
Associates, Inc.  
Albany, Georgia

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**Jonathan W. R. Ross**

*President*  
Ross Construction Co., Inc.  
Tifton, Georgia

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**DIRECTORS  
EMERITUS** FOR  
COLONY BANK

*Left to Right: Marion H. Masee, III, Harold Kimball,  
Ben B. Mills, and Joe K. Shiver  
Not pictured: L. Morris Downing, Jr. and Ralph D. Roberts, MD*



Eddie Hoyle,  
EVP Regional  
Executive Officer

# West MARKET

Cordele  
Moultrie  
Sylvester  
Warner Robins/  
Centerville  
Albany/Leesburg  
Columbus  
Thomaston  
Tifton  
Ashburn

*Second row:*  
Market Presidents  
Ricky Freeman, Ashburn  
John Gandy, Moultrie  
Jeffery Alton, Thomaston  
Walter Patton, Sylvester

*Third row:*  
Kirk Scott, Warner Robins  
Bob Evans, Cordele  
John Roberts, Columbus  
Phil Franklin, Albany  
Bill Marsh, Tifton

“ Our dedicated, experienced West Market team is focused on growth in market share, in relationship depth with current customers, and in our commitment to support the communities and companies in the Colony Bank West Market footprint. ”

EDDIE HOYLE



“Colony Bank East Market team combined professional banking expertise and products with personal service to enhance the lives of the people we serve. That dual emphasis serves to successfully differentiate our bank from both traditional and non-traditional competitors and deliver significant market advantage.”

LEE A. NORTHCUTT

Douglas/Broxtown

Eastman/Chester/  
Soperton

Valdosta

Quitman

Savannah

Rochelle/Pitts

Fitzgerald

Second row from left to right:

Market Presidents

Eddie Smith, Valdosta

Scott Miller, Douglas

Andy Johnson, Eastman

Nic Worthy, Rochelle

Chip Carroll, Quitman

Mark Turner, Fitzgerald

Tommy Hester, Savannah

# East MARKET



Lee A. Northcutt,  
EVP Regional  
Executive Officer

# How Colony Bank Puts *Innovation* to Work

*Following is an excerpt from the 4th Quarter 2013 issue of BizTech Magazine, which featured Colony Bank's information technology initiative to improve internal business processes, enhance operating efficiency and reduce operational costs.*

*This initiative exemplifies Colony's proactive commitment to optimizing productivity and customer responsiveness.*

When Vice President of Information Technology Greg Judy and his staff at Colony Bank evaluated the latest in unified communications and collaboration technologies, they saw a range of potential benefits. A Voice over IP (VoIP) phone system and standard UC services such as four-digit speed dialing, centralized management of extensions and calling queues, instant messaging (IM) and video conferencing would not only reduce costs, but also could improve internal business processes and enhance customer service.

Armed with a clear analysis of these benefits, Judy's department received a formal commitment from Senior Vice President, Technology Officer Jim Jowers, who played a key role in selecting a Cisco Systems-based solution for Colony Bank's Fitzgerald, Ga., headquarters and a handful of branches this year. Remaining facilities across Georgia are scheduled for upgrades in 2014.

Building a solid business case for UC rests on two main pillars: eliminating the costs and complexities of traditional phone systems and launching a host of new communications and collaboration services enabled by modern platforms.

Experts like Judy and others agree that the following core benefits can help win commitments from senior managers.

## **Reduced Management Complexity**

Each of Colony Bank's 30 facilities have relied on separate phone systems under individual contracts with local providers. That's 30 separate systems to pay for; and when it's necessary to add or move an extension, a Colony Bank staffer must schedule a service call, at about \$115 an hour.

With UC in place, new four-digit phone extensions now let bank staff quickly connect with peers at any location. IT administrators can centrally manage one phone system that serves all 30 locations and lets them add extensions and perform other routine duties remotely. "I'm looking forward to being able to manage and control everything ourselves," says David Sheffield, network administrator at Colony Bank.

**Greg Judy**  
Vice President of Information Technology



McNAIR, McLEMORE, MIDDLEBROOKS & Co., LLC

CERTIFIED PUBLIC ACCOUNTANTS

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*www.mmmcpa.com*

March 14, 2014

**REPORT OF INDEPENDENT  
REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders  
Colony Bankcorp, Inc.

We have audited the accompanying consolidated balance sheets of **Colony Bankcorp, Inc. and Subsidiary** as of December 31, 2013 and 2012 and the related consolidated statements of operations, comprehensive income (loss), changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Colony Bankcorp, Inc. and Subsidiary as of December 31, 2013 and 2012, and the results of its operations and cash flows for each of the years in the three-year period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America.

We were not engaged to examine management's assessment of the effectiveness of Colony Bankcorp, Inc.'s internal control over financial reporting as of December 31, 2013 included under Item 9A, *Controls and Procedures*, in Colony Bankcorp, Inc.'s Annual Report on Form 10-K and, accordingly, we do not express an opinion thereon.

*McNair, McLemore, Middlebrooks & Co., LLC*  
McNAIR, McLEMORE, MIDDLEBROOKS & CO., LLC

**COLONY BANKCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31**

**ASSETS**

	<u>2013</u>	<u>2012</u>
<b>Cash and Cash Equivalents</b>		
Cash and Due from Banks	\$ 25,691,605	\$ 29,243,927
Federal Funds Sold	20,495,060	20,001,906
	<u>46,186,665</u>	<u>49,245,833</u>
<b>Interest-Bearing Deposits</b>	<u>21,960,291</u>	<u>21,795,341</u>
<b>Investment Securities</b>		
Available for Sale, at Fair Value	263,257,890	268,300,411
Held to Maturity, at Cost (Fair Value of \$37,309 and \$41,909 as of December 31, 2013 and 2012, Respectively)	37,062	41,467
	<u>263,294,952</u>	<u>268,341,878</u>
<b>Federal Home Loan Bank Stock, at Cost</b>	<u>3,163,900</u>	<u>3,364,300</u>
<b>Loans</b>	751,218,462	747,050,011
Allowance for Loan Losses	(11,805,986)	(12,736,921)
Unearned Interest and Fees	(360,522)	(233,927)
	<u>739,051,954</u>	<u>734,079,163</u>
<b>Premises and Equipment</b>	<u>24,876,469</u>	<u>24,916,106</u>
<b>Other Real Estate (Net of Allowance of \$3,985,920 and \$4,561,099 in 2013 and 2012, Respectively)</b>	<u>15,502,462</u>	<u>15,940,693</u>
<b>Other Intangible Assets</b>	<u>187,761</u>	<u>223,510</u>
<b>Other Assets</b>	<u>34,326,432</u>	<u>21,489,957</u>
<b>Total Assets</b>	<u><u>\$1,148,550,886</u></u>	<u><u>\$1,139,396,781</u></u>

See accompanying notes which are an integral part of these financial statements.

**COLONY BANKCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31**

**LIABILITIES AND STOCKHOLDERS' EQUITY**

	<b>2013</b>	<b>2012</b>
<b>Deposits</b>		
Noninterest-Bearing	\$ 115,260,701	\$ 123,966,542
Interest-Bearing	872,268,779	855,718,349
	<b>987,529,480</b>	979,684,891
<b>Borrowed Money</b>		
Subordinated Debentures	24,229,000	24,229,000
Other Borrowed Money	40,000,000	35,000,000
	<b>64,229,000</b>	59,229,000
<b>Other Liabilities</b>	<b>6,838,167</b>	4,723,723
 <b>Commitments and Contingencies</b>		
 <b>Stockholders' Equity</b>		
Preferred Stock, Stated Value \$1,000; Authorized 10,000,000 Shares, Issued 28,000 Shares	28,000,000	27,827,053
Common Stock, Par Value \$1; Authorized 20,000,000 Shares, Issued 8,439,258 Shares as of December 31, 2013 and 2012	8,439,258	8,439,258
Paid-In Capital	29,145,094	29,145,094
Retained Earnings	33,444,913	30,497,576
Accumulated Other Comprehensive Loss, Net of Tax	(9,075,026)	(149,814)
	<b>89,954,239</b>	95,759,167
 <b>Total Liabilities and Stockholders' Equity</b>	<b>\$1,148,550,886</b>	\$1,139,396,781

See accompanying notes which are an integral part of these financial statements.

**COLONY BANKCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 31**

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>Interest Income</b>			
Loans, Including Fees	\$41,350,195	\$41,963,113	\$44,460,149
Federal Funds Sold and Securities Purchased Under Agreements to Resell	39,199	99,273	114,794
Deposits with Other Banks	26,704	42,903	45,646
Investment Securities			
U.S. Government Agencies	3,516,978	4,824,423	6,873,296
State, County and Municipal	123,972	206,483	160,892
Corporate Obligations	47,275	76,029	91,034
Dividends on Other Investments	81,398	77,203	47,001
	<u>45,185,721</u>	<u>47,289,427</u>	<u>51,792,812</u>
<b>Interest Expense</b>			
Deposits	5,821,366	8,737,281	12,950,229
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	116	-	337,711
Borrowed Money	1,675,164	2,279,469	3,517,633
	<u>7,496,646</u>	<u>11,016,750</u>	<u>16,805,573</u>
<b>Net Interest Income</b>	<u>37,689,075</u>	<u>36,272,677</u>	<u>34,987,239</u>
Provision for Loan Losses	4,485,000	6,784,767	8,250,000
<b>Net Interest Income After Provision for Loan Losses</b>	<u>33,204,075</u>	<u>29,487,910</u>	<u>26,737,239</u>
<b>Noninterest Income</b>			
Service Charges on Deposits	4,690,599	3,572,897	3,244,536
Other Service Charges, Commissions and Fees	1,725,271	1,514,898	1,311,758
Mortgage Fee Income	484,396	400,009	265,636
Securities Gains (Losses)	(363,804)	2,837,464	2,923,601
Gain on Sale of SBA Loans	635,190	305,924	946,732
Other	1,205,631	1,102,077	1,258,813
	<u>8,377,283</u>	<u>9,733,269</u>	<u>9,951,076</u>
<b>Noninterest Expenses</b>			
Salaries and Employee Benefits	16,691,972	15,564,893	14,632,693
Occupancy and Equipment	3,794,524	3,878,268	3,997,667
Directors' Fees	416,972	465,220	466,075
Legal and Professional Fees	721,322	1,085,881	1,186,884
Foreclosed Property	3,918,128	5,613,316	4,045,245
FDIC Assessment	1,321,981	1,497,974	1,828,799
Advertising	508,292	422,718	508,329
Software	852,475	789,226	660,120
Telephone	778,151	744,930	735,758
ATM/Card Processing	641,228	511,186	348,221
Other	4,972,404	4,805,418	4,641,046
	<u>34,617,449</u>	<u>35,379,030</u>	<u>33,050,837</u>
<b>Income Before Income Taxes</b>	<u>6,963,909</u>	<u>3,842,149</u>	<u>3,637,478</u>
<b>Income Taxes</b>	<u>2,334,864</u>	<u>1,200,851</u>	<u>1,103,883</u>
<b>Net Income</b>	<u>4,629,045</u>	<u>2,641,298</u>	<u>2,533,595</u>
Preferred Stock Dividends	1,508,761	1,435,385	1,400,000
<b>Net Income Available to Common Stockholders</b>	<u>\$ 3,120,284</u>	<u>\$ 1,205,913</u>	<u>\$ 1,133,595</u>
<b>Net Income Per Share of Common Stock, Basic and Diluted</b>	<u>\$ 0.37</u>	<u>\$ 0.14</u>	<u>\$ 0.13</u>
<b>Cash Dividends Declared Per Share of Common Stock</b>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>
<b>Weighted Average Shares Outstanding, Basic and Diluted</b>	<u>8,439,258</u>	<u>8,439,258</u>	<u>8,439,258</u>

See accompanying notes which are an integral part of these financial statements.

**COLONY BANKCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**FOR THE YEARS ENDED DECEMBER 31**

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>Net Income</b>	<u>\$ 4,629,045</u>	<u>\$ 2,641,298</u>	<u>\$ 2,533,595</u>
<b>Other Comprehensive Income (Loss), Net of Tax</b>			
Gains (Losses) on Securities Arising During the Year, Net of Tax Effect of \$(4,597,836), \$(1,060,984) and \$1,292,789, Respectively	(9,165,323)	(186,830)	4,439,108
Impairment Loss on Securities, Net of Tax Effect of \$(124,652), \$(20,253) and \$(18,040), Respectively	241,971	39,315	35,018
Realized Gains (Losses) on Sale of AFS Securities, Net of Tax Effect of \$959, \$984,991 and \$1,012,064, Respectively	<u>(1,860)</u>	<u>(1,912,041)</u>	<u>(1,964,595)</u>
Change in Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects	<u>(8,925,212)</u>	<u>(2,059,556)</u>	<u>2,509,531</u>
<b>Comprehensive Income (Loss)</b>	<u><u>\$ (4,296,167)</u></u>	<u><u>\$ 581,742</u></u>	<u><u>\$ 5,043,126</u></u>

See accompanying notes which are an integral part of these financial statements.

**COLONY BANKCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2013, 2012 AND 2011**

	Preferred Stock	Shares Issued	Common Stock	Paid-In Capital	Retained Earnings	Restricted Stock - Unearned Compensation	Accumulated Other Comprehensive Income (Loss)	Total
<b>Balance, December 31, 2010</b>	\$27,505,910	8,442,958	\$8,442,958	\$29,171,087	\$28,479,211	\$(40,794)	\$ (599,789)	\$92,958,583
Forfeiture of Restricted Stock		(3,700)	(3,700)	(25,993)		29,693		-
Amortization of Unearned Compensation						11,101		11,101
Change in Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects							2,509,531	2,509,531
Accretion of Fair Value of Warrant	156,566				(156,566)			-
Dividends on Preferred Shares					(1,400,000)			(1,400,000)
Net Income					2,533,595			2,533,595
<b>Balance, December 31, 2011</b>	27,662,476	8,439,258	8,439,258	29,145,094	29,456,240	-	1,909,742	96,612,810
Change in Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects							(2,059,556)	(2,059,556)
Accretion of Fair Value of Warrant	164,577				(164,577)			-
Dividends on Preferred Shares					(1,435,385)			(1,435,385)
Net Income					2,641,298			2,641,298
<b>Balance, December 31, 2012</b>	27,827,053	8,439,258	8,439,258	29,145,094	30,497,576	-	(149,814)	95,759,167
Change in Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects							(8,925,212)	(8,925,212)
Accretion of Fair Value of Warrant	172,947				(172,947)			-
Dividends on Preferred Shares					(1,508,761)			(1,508,761)
Net Income					4,629,045			4,629,045
<b>Balance, December 31, 2013</b>	<b>\$28,000,000</b>	<b>8,439,258</b>	<b>\$8,439,258</b>	<b>\$29,145,094</b>	<b>\$33,444,913</b>	<b>\$ -</b>	<b>\$ (9,075,026)</b>	<b>\$89,954,239</b>

See accompanying notes which are an integral part of these financial statements.



**COLONY BANKCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31**

	2013	2012	2011
<b>Cash Flows from Operating Activities</b>			
Net Income	\$ 4,629,045	\$ 2,641,298	\$ 2,533,595
Adjustments to Reconcile Net Income to Net Cash Provided from Operating Activities			
Depreciation	1,527,392	1,676,820	1,790,041
Amortization and Accretion	2,667,404	4,180,158	3,487,124
Provision for Loan Losses	4,485,000	6,784,767	8,250,000
Deferred Income Taxes	2,178,222	1,204,439	867,006
Securities (Gains) Losses	363,804	(2,837,464)	(2,923,601)
(Gain) Loss on Sale of Premises and Equipment	(677)	1,148	3,668
Loss on Sale of Other Real Estate and Repossessions	1,565,091	1,839,196	1,106,479
Provision for Losses on Other Real Estate	1,321,418	2,702,709	1,411,061
Increase in Cash Surrender Value of Life Insurance	(338,712)	(185,341)	(174,289)
<b>Change In</b>			
Interest Receivable	285,033	250,755	739,423
Prepaid Expenses	(168,060)	1,741,834	1,861,810
Interest Payable	385,285	74,637	(398,903)
Accrued Expenses and Accounts Payable	213,753	(95,972)	(405,612)
Other	(243,543)	2,827,648	(2,987,906)
	<b>18,870,455</b>	<b>22,806,632</b>	<b>15,159,896</b>
<b>Cash Flows from Investing Activities</b>			
Interest-Bearing Deposits in Other Banks	(164,950)	7,161,969	21,769,424
Purchase of Investment Securities			
Available for Sale	(132,419,073)	(250,445,594)	(381,284,748)
Proceeds from Sale of Investment Securities			
Available for Sale	72,672,795	227,690,806	342,672,937
Proceeds from Maturities, Calls and Paydowns of Investment Securities			
Available for Sale	48,330,382	54,006,594	41,978,769
Held to Maturity	11,623	14,019	12,565
Proceeds from Sale of Premises and Equipment	2,500	1,500	1,605
Net Loans to Customers	(19,959,948)	(50,126,252)	63,267,200
Purchase of Premises and Equipment	(1,489,579)	(845,338)	(397,825)
Proceeds from Sale of Other Real Estate and Repossessions	8,041,638	9,876,136	9,991,792
Proceeds from Sale of Federal Home Loan Bank Stock	200,400	2,033,900	665,300
Purchase of Bank-Owned Life Insurance	(10,000,000)	-	-
	<b>(34,774,212)</b>	<b>(632,260)</b>	<b>98,677,019</b>
<b>Cash Flows from Financing Activities</b>			
Interest-Bearing Customer Deposits	16,550,430	(49,998,012)	(50,448,220)
Noninterest-Bearing Customer Deposits	(8,705,841)	29,697,631	(8,690,512)
Proceeds from Other Borrowed Money	21,500,000	5,000,000	-
Principal Payments on Other Borrowed Money	(16,500,000)	(41,000,000)	(4,076,010)
Dividends Paid on Preferred Stock	-	-	(1,400,000)
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	-	-	(20,000,000)
	<b>12,844,589</b>	<b>(56,300,381)</b>	<b>(84,614,742)</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>(3,059,168)</b>	<b>(34,126,009)</b>	<b>29,222,173</b>
<b>Cash and Cash Equivalents, Beginning</b>	<b>49,245,833</b>	<b>83,371,842</b>	<b>54,149,669</b>
<b>Cash and Cash Equivalents, Ending</b>	<b>\$ 46,186,665</b>	<b>\$ 49,245,833</b>	<b>\$ 83,371,842</b>

See accompanying notes which are an integral part of these financial statements.

## COLONY BANKCORP, INC. AND SUBSIDIARY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### (1) Summary of Significant Accounting Policies

##### Principles of Consolidation

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

##### Nature of Operations

The Company provides a full range of retail and commercial banking services for consumers and small- to medium-size businesses located primarily in central, south and coastal Georgia. Colony Bank is headquartered in Fitzgerald, Georgia with banking offices in Albany, Ashburn, Broxton, Centerville, Chester, Columbus, Cordele, Douglas, Eastman, Fitzgerald, Leesburg, Moultrie, Pitts, Quitman, Rochelle, Savannah, Soperton, Sylvester, Thomaston, Tifton, Valdosta and Warner Robins. Lending and investing activities are funded primarily by deposits gathered through its retail banking office network.

##### Use of Estimates

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

##### Reclassifications

In certain instances, amounts reported in prior years' consolidated financial statements and note disclosures have been reclassified to conform to statement presentations selected for 2013. Such reclassifications had no effect on previously reported stockholders' equity or net income.

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Concentrations of Credit Risk**

Concentrations of credit risk can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries or certain geographic regions. The Company has a concentration in real estate loans as well as a geographic concentration that could pose an adverse credit risk, particularly with the current economic downturn in the real estate market. At December 31, 2013, approximately 87 percent of the Company's loan portfolio was concentrated in loans secured by real estate. A substantial portion of borrowers' ability to honor their contractual obligations is dependent upon the viability of the real estate economic sector. The downturn of the housing and real estate market that began in 2007 resulted in an increase of problem loans secured by real estate, of which most are centered in the Company's larger MSA markets. Declining collateral real estate values that secure land development, construction and speculative real estate loans in the Company's larger MSA markets have resulted in high loan loss provisions in recent years. In addition, a large portion of the Company's foreclosed assets are also located in these same geographic markets, making the recovery of the carrying amount of foreclosed assets susceptible to changes in market conditions. Management continues to monitor these concentrations and has considered these concentrations in its allowance for loan loss analysis.

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

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

### **Investment Securities**

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

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Investment Securities (Continued)**

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

### **Federal Home Loan Bank Stock**

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

### **Loans**

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

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

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

### **Loans Modified in a Troubled Debt Restructuring (TDR)**

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

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Allowance for Loan Losses**

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

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

The allowance consists of specific, historical and general components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The historical component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors. A general component is maintained to cover uncertainties that could affect management's estimate of probable losses. The general component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and historical losses in the portfolio. General valuation allowances are based on internal and external qualitative risk factors such as (1) changes in the composition of the loan portfolio, (2) the extent of loan concentrations within the portfolio, (3) the effectiveness of the Company's lending policies, procedures and internal controls, (4) the experience, ability and effectiveness of the Company's lending management and staff, and (5) national and local economics and business conditions.

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

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

## (1) Summary of Significant Accounting Policies (Continued)

### Allowance for Loan Losses (Continued)

A significant portion of the Company's impaired loans are deemed to be collateral dependent. Management therefore measures impairment on these loans based on the fair value of the collateral. Collateral values are determined based on appraisals performed by qualified licensed appraisers hired by the Company or by senior members of the Company's credit administration staff. The decision whether or not to obtain an external third-party appraisal usually depends on the type of property being evaluated. External appraisals are usually obtained on more complex, income producing properties such as hotels, shopping centers and businesses. Less complex properties such as residential lots, farm land and single family houses may be evaluated internally by senior credit administration staff. When the Company does obtain appraisals from external third-parties, the values utilized in the impairment calculation are "as is" or current market values. The appraisals, whether prepared internally or externally, may utilize a single valuation approach or a combination of approaches including the comparable sales, income and cost approach. Appraised amounts used in the impairment calculation are typically discounted 10 percent to account for selling and marketing costs, if the repayment of the loan is to come from the sale of the collateral. Although appraisals may not be obtained each year on all impaired loans, the collateral values used in the impairment calculations are evaluated quarterly by management. Based on management's knowledge of the collateral and the current real estate market conditions, appraised values may be further discounted to reflect facts and circumstances known to management since the initial appraisal was performed.

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

### Premises and Equipment

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

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

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

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

### Intangible Assets

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

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Transfers of Financial Assets**

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

### **Statement of Cash Flows**

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

### **Securities Purchased Under Agreement to Resell and Securities Sold Under Agreements to Repurchase**

The Company purchases certain securities under agreements to resell. The amounts advanced under these agreements represent short-term loans and are reflected as assets in the consolidated balance sheets.

The Company sells securities under agreements to repurchase. These repurchase agreements are treated as borrowings. The obligations to repurchase securities sold are reflected as a liability and the securities underlying the agreements are reflected as assets in the consolidated balance sheets.

### **Advertising Costs**

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

### **Income Taxes**

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

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

The Company's federal and state income tax returns for tax years 2013, 2012, 2011 and 2010 are subject to examination by the Internal Revenue Service (IRS) and the Georgia Department of Revenue, generally for three years after filing.

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Income Taxes (Continued)**

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

### **Other Real Estate**

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

### **Bank-Owned Life Insurance**

The Company has purchased life insurance on the lives of certain key members of management and directors. The life insurance policies are recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or amounts due that are probable at settlement, if applicable. Increases in the cash surrender value are recorded as other income in the consolidated statements of income. The cash surrender value of the insurance contracts is recorded in other assets on the consolidated balance sheets in the amount of \$13,940,176 and \$3,601,464 as of December 31, 2013 and 2012, respectively.

### **Comprehensive Income**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale, represent equity changes from economic events of the period other than transactions with owners. Such items are considered components of other comprehensive income (loss). Accounting standards codification requires the presentation in the consolidated financial statements of net income and all items of other comprehensive income (loss) as total comprehensive income (loss).

### **Off-Balance Sheet Credit Related Financial Instruments**

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



## (1) Summary of Significant Accounting Policies (Continued)

### Changes in Accounting Principles and Effects of New Accounting Pronouncements

#### *Adoption of New Accounting Standards*

ASU 2013-02, *Comprehensive Income (Topic 220) - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. ASU 2013-02 amends recent guidance related to the reporting of comprehensive income to enhance the reporting of reclassifications out of accumulated other comprehensive income. ASU 2013-02 became effective for the Company on January 1, 2013 and did not have a significant impact on the Company's consolidated financial statements.

ASU 2012-02, *Intangibles - Goodwill and Other (Topic 350) - Testing Indefinite-Lived Intangible Assets for Impairment*. ASU 2012-02 gives entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events or circumstances, an entity determines it is more likely than not that an indefinite-lived intangible asset is impaired, then the entity must perform the quantitative impairment test. If, under the quantitative impairment test, the carrying amount of the intangible asset exceeds its fair value, an entity should recognize an impairment loss in the amount of that excess. Permitting an entity to assess qualitative factors when testing indefinite-lived intangible assets for impairment results in guidance that is similar to the goodwill impairment testing guidance in ASU 2011-08. ASU 2012-02 became effective for the Company on January 1, 2013 and did not have a significant impact on the Company's consolidated financial statements.

ASU 2011-11, *Balance Sheet (Topic 210) - Disclosures about Offsetting Assets and Liabilities*. ASU 2011-11 amends Topic 210, *Balance Sheet*, to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the consolidated balance sheet and/or subject to a master netting arrangement or similar agreement. ASU No. 2013-01, *Balance Sheet (Topic 210) - Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*, clarifies that ordinary trade receivables are not within the scope of ASU 2011-11. ASU 2011-11 became effective for the Company on January 1, 2013 and did not have a significant impact on the Company's consolidated financial statements.

## (2) Cash and Balances Due from Banks

Components of cash and balances due from banks are as follows as of December 31:

	<u>2013</u>	<u>2012</u>
Cash on Hand and Cash Items	<b>\$10,531,340</b>	\$ 9,063,437
Noninterest-Bearing Deposits with Other Banks	<b>15,160,265</b>	20,180,490
	<b><u>\$25,691,605</u></b>	<b><u>\$29,243,927</u></b>

The Company is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank based on a percentage of deposits. Reserve balances totaled approximately \$1,252,000 and \$6,065,000 at December 31, 2013 and 2012, respectively.

### (3) Investment Securities

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

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b>Securities Available for Sale</b>				
U.S. Government Agencies				
Mortgage-Backed	\$273,029,073	\$ 118,843	\$(13,799,858)	\$259,348,058
State, County and Municipal	<u>3,978,857</u>	<u>14,963</u>	<u>(83,988)</u>	<u>3,909,832</u>
	<u>\$277,007,930</u>	<u>\$ 133,806</u>	<u>\$ (13,883,846)</u>	<u>\$263,257,890</u>
<b>Securities Held to Maturity</b>				
State, County and Municipal	<u>\$ 37,062</u>	<u>\$ 247</u>	<u>\$ -</u>	<u>\$ 37,309</u>

The amortized cost and fair value of investment securities as of December 31, 2013, by contractual maturity, are shown hereafter. Expected maturities may differ from contractual maturities for certain investments because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. This is often the case with mortgage-backed securities, which are disclosed separately in the table below.

	<b>Securities</b>			
	<u>Available for Sale</u>		<u>Held to Maturity</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in One Year or Less	\$ 272,219	\$ 274,166	\$ -	\$ -
Due After One Year Through Five Years	1,755,607	1,768,121	37,062	37,309
Due After Five Years Through Ten Years	1,298,122	1,265,127	-	-
Due After Ten Years	<u>652,909</u>	<u>602,418</u>	<u>-</u>	<u>-</u>
	3,978,857	3,909,832	37,062	37,309
Mortgage-Backed Securities	<u>273,029,073</u>	<u>259,348,058</u>	<u>-</u>	<u>-</u>
	<u>\$277,007,930</u>	<u>\$263,257,890</u>	<u>\$37,062</u>	<u>\$37,309</u>

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

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b>Securities Available for Sale</b>				
U.S. Government Agencies				
Mortgage-Backed	\$263,186,852	\$833,920	\$ (961,698)	\$263,059,074
State, County and Municipal	3,973,926	34,670	(4,586)	4,004,010
Corporate Obligations	1,000,000	104,900	-	1,104,900
Asset-Backed Securities	<u>366,623</u>	<u>-</u>	<u>(234,196)</u>	<u>132,427</u>
	<u>\$268,527,401</u>	<u>\$973,490</u>	<u>\$(1,200,480)</u>	<u>\$268,300,411</u>
<b>Securities Held to Maturity</b>				
State, County and Municipal	<u>\$ 41,467</u>	<u>\$ 442</u>	<u>\$ -</u>	<u>\$ 41,909</u>

### (3) Investment Securities (Continued)

Proceeds from sales of investments available for sale were \$72,672,795 in 2013, \$227,690,806 in 2012 and \$342,672,937 in 2011. Gross realized gains totaled \$442,124 in 2013, \$3,084,666 in 2012 and \$2,978,193 in 2011. Gross realized losses totaled \$805,928 in 2013, \$247,202 in 2012 and \$54,592 in 2011.

Nonaccrual securities are securities for which principal and interest are doubtful of collection in accordance with original terms and for which accruals of interest have been discontinued due to payment delinquency. Fair value of securities on nonaccrual status totaled \$0 and \$132,427 as of December 31, 2013 and 2012, respectively.

Investment securities having a carrying value totaling \$112,912,815 and \$117,450,817 as of December 31, 2013 and 2012, respectively, were pledged to secure public deposits and for other purposes.

Information pertaining to securities with gross unrealized losses at December 31, 2013 and 2012 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>December 31, 2013</b>						
U.S. Government Agencies						
Mortgage-Backed	\$190,063,827	\$(9,440,663)	\$63,193,601	\$(4,359,195)	\$253,257,428	\$(13,799,858)
State, County and Municipal	1,647,043	(83,988)	-	-	1,647,043	(83,988)
	<u>\$191,710,870</u>	<u>\$(9,524,651)</u>	<u>\$63,193,601</u>	<u>\$(4,359,195)</u>	<u>\$254,904,471</u>	<u>\$(13,883,846)</u>
<b>December 31, 2012</b>						
U.S. Government Agencies						
Mortgage-Backed	\$142,103,991	\$(961,698)	\$ -	\$ -	\$142,103,991	\$ (961,698)
State, County and Municipal	1,430,512	(4,586)	-	-	1,430,512	(4,586)
Asset-Backed Securities	-	-	132,427	(234,196)	132,427	(234,196)
	<u>\$143,534,503</u>	<u>\$(966,284)</u>	<u>\$132,427</u>	<u>\$(234,196)</u>	<u>\$143,666,930</u>	<u>\$(1,200,480)</u>

Management evaluates securities for other than temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

### (3) Investment Securities (Continued)

At December 31, 2013, the debt securities with unrealized losses have depreciated 5.17 percent from the Company's amortized cost basis. These securities are guaranteed by either the U.S. Government, other governments or U.S. corporations. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other than temporary. However, the Company did own one asset-backed security at December 31, 2013 which has been completely written off. This investment is comprised of one issuance of a trust preferred security and has a book value of \$0. Management evaluates this investment on a quarterly basis utilizing a third-party valuation model. The results of this model revealed other-than-temporary impairment and as a result, \$366,623, \$59,568 and \$53,058 were written off during the years ended December 31, 2013, 2012 and 2011, respectively.

### (4) Loans

The following table presents the composition of loans, segregated by class of loans, as of December 31:

	<u>2013</u>	<u>2012</u>
<b>Commercial and Agricultural</b>		
Commercial	\$ 48,107,448	\$ 55,684,492
Agricultural	10,665,938	6,210,953
<b>Real Estate</b>		
Commercial Construction	52,738,783	53,808,056
Residential Construction	6,549,260	5,852,238
Commercial	341,783,538	334,386,177
Residential	206,257,927	203,844,522
Farmland	47,034,426	49,056,861
<b>Consumer and Other</b>		
Consumer	25,675,560	29,777,776
Other	12,405,582	8,428,936
<b>Total Loans</b>	<u><u>\$751,218,462</u></u>	<u><u>\$747,050,011</u></u>

#### **(4) Loans (Continued)**

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

*Credit Quality Indicators.* As part of the ongoing monitoring of the credit quality of the loan portfolio, management tracks certain credit quality indicators including trends related to (1) the risk grade assigned to commercial and consumer loans, (2) the level of classified commercial loans, (3) net charge-offs, (4) nonperforming loans, and (5) the general economic conditions in the Company's geographic markets.

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

- Grades 1 and 2 - Borrowers with these assigned grades range in risk from virtual absence of risk to minimal risk. Such loans may be secured by Company-issued and controlled certificates of deposit or properly margined equity securities or bonds. Other loans comprising these grades are made to companies that have been in existence for a long period of time with many years of consecutive profits and strong equity, good liquidity, excellent debt service ability and unblemished past performance, or to exceptionally strong individuals with collateral of unquestioned value that fully secures the loans. Loans in this category fall into the "pass" classification.
- Grades 3 and 4 - Loans assigned these "pass" risk grades are made to borrowers with acceptable credit quality and risk. The risk ranges from loans with no significant weaknesses in repayment capacity and collateral protection to acceptable loans with one or more risk factors considered to be more than average.
- Grade 5 - This grade includes "special mention" loans on management's watch list and is intended to be used on a temporary basis for pass grade loans where risk-modifying action is intended in the short-term.
- Grade 6 - This grade includes "substandard" loans in accordance with regulatory guidelines. This category includes borrowers with well-defined weaknesses that jeopardize the payment of the debt in accordance with the agreed terms. Loans considered to be impaired are assigned this grade, and these loans often have assigned loss allocations as part of the allowance for loan and lease losses. Generally, loans on which interest accrual has been stopped would be included in this grade.
- Grades 7 and 8 - These grades correspond to regulatory classification definitions of "doubtful" and "loss," respectively. In practice, any loan with these grades would be for a very short period of time, and generally the Company has no loans with these assigned grades. Management manages the Company's problem loans in such a way that uncollectible loans or uncollectible portions of loans are charged off immediately with any residual, collectible amounts assigned a risk grade of 6.

#### (4) Loans (Continued)

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

2013	Pass	Special Mention	Substandard	Total Loans
<b>Commercial and Agricultural</b>				
Commercial	\$ 41,759,281	\$ 2,770,284	\$ 3,577,883	\$48,107,448
Agricultural	10,637,705	16,830	11,403	10,665,938
<b>Real Estate</b>				
Commercial Construction	42,668,320	1,512,301	8,558,162	52,738,783
Residential Construction	6,341,530	207,730	-	6,549,260
Commercial	317,567,749	10,759,954	13,455,835	341,783,538
Residential	182,977,361	13,523,478	9,757,088	206,257,927
Farmland	44,776,355	507,122	1,750,949	47,034,426
<b>Consumer and Other</b>				
Consumer	24,608,175	320,473	746,912	25,675,560
Other	12,356,116	711	48,755	12,405,582
<b>Total Loans</b>	<b>\$683,692,592</b>	<b>\$29,618,883</b>	<b>\$37,906,987</b>	<b>\$751,218,462</b>
2012				
<b>Commercial and Agricultural</b>				
Commercial	\$ 49,947,552	\$ 1,417,735	\$ 4,319,205	\$ 55,684,492
Agricultural	6,155,864	-	55,089	6,210,953
<b>Real Estate</b>				
Commercial Construction	37,256,301	1,663,588	14,888,167	53,808,056
Residential Construction	5,748,829	103,409	-	5,852,238
Commercial	298,222,139	9,759,473	26,404,565	334,386,177
Residential	183,222,020	11,412,973	9,209,529	203,844,522
Farmland	45,495,038	913,487	2,648,336	49,056,861
<b>Consumer and Other</b>				
Consumer	28,839,058	293,467	645,251	29,777,776
Other	8,350,772	8,907	69,257	8,428,936
<b>Total Loans</b>	<b>\$663,237,573</b>	<b>\$25,573,039</b>	<b>\$58,239,399</b>	<b>\$747,050,011</b>

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

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

#### (4) Loans (Continued)

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

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

2013	Accruing Loans			Nonaccrual Loans	Current Loans	Total Loans
	30-89 Days Past Due	90 Days or More Past Due	Total Accruing Loans Past Due			
<b>Commercial and Agricultural</b>						
Commercial	\$ 581,281	\$ -	\$ 581,281	\$ 1,646,418	\$ 45,879,749	\$ 48,107,448
Agricultural	81,036	-	81,036	-	10,584,902	10,665,938
<b>Real Estate</b>						
Commercial Construction	139,826	-	139,826	8,221,745	44,377,212	52,738,783
Residential Construction	-	-	-	-	6,549,260	6,549,260
Commercial	2,287,341	-	2,287,341	7,366,703	332,129,494	341,783,538
Residential	5,273,586	-	5,273,586	4,933,420	196,050,921	206,257,927
Farmland	350,718	-	350,718	1,629,611	45,054,097	47,034,426
<b>Consumer and Other</b>						
Consumer	453,580	3,991	457,571	307,456	24,910,533	25,675,560
Other	198,451	-	198,451	9,146	12,197,985	12,405,582
<b>Total Loans</b>	<b>\$9,365,819</b>	<b>\$ 3,991</b>	<b>\$9,369,810</b>	<b>\$24,114,499</b>	<b>\$717,734,153</b>	<b>\$751,218,462</b>
2012						
<b>Commercial and Agricultural</b>						
Commercial	\$ 797,612	\$ -	\$ 797,612	\$ 1,033,371	\$ 53,853,509	\$ 55,684,492
Agricultural	28,228	-	28,228	39,213	6,143,512	6,210,953
<b>Real Estate</b>						
Commercial Construction	1,309,618	-	1,309,618	14,032,580	38,465,858	53,808,056
Residential Construction	-	-	-	-	5,852,238	5,852,238
Commercial	3,771,106	-	3,771,106	6,629,789	323,985,282	334,386,177
Residential	8,223,174	-	8,223,174	5,429,971	190,191,377	203,844,522
Farmland	140,095	-	140,095	2,413,104	46,503,662	49,056,861
<b>Consumer and Other</b>						
Consumer	636,888	4,355	641,243	255,216	28,881,317	29,777,776
Other	4,557	-	4,557	17,491	8,406,888	8,428,936
<b>Total Loans</b>	<b>\$14,911,278</b>	<b>\$ 4,355</b>	<b>\$14,915,633</b>	<b>\$29,850,735</b>	<b>\$702,283,643</b>	<b>\$747,050,011</b>

#### (4) Loans (Continued)

During its review of impaired loans, the Company determined the majority of its exposures on these loans were known losses. As a result, the exposures were charged off, reducing the specific allowances on impaired loans. Had nonaccrual loans performed in accordance with their original contractual terms, the Company would have recognized additional interest income of approximately \$968,700, \$1,634,600 and \$1,639,800 for the years ended December 31, 2013, 2012 and 2011, respectively.

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

	Unpaid Contractual Principal Balance	Impaired Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Collected
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 305,272	\$ 305,272	\$ -	\$ 216,057	\$ 24,494	\$ 25,193
Agricultural	-	-	-	9,803	-	-
Commercial Construction	7,856,411	4,750,157	-	4,105,370	34,908	41,164
Commercial Real Estate	20,120,403	19,252,946	-	13,198,988	493,940	503,392
Residential Real Estate	7,836,718	6,361,592	-	4,564,666	224,439	209,330
Farmland	302,629	302,629	-	1,858,654	803	869
Consumer	313,194	307,456	-	252,944	18,469	21,109
Other	9,146	9,146	-	2,287	556	575
	<u>36,743,773</u>	<u>31,289,198</u>	<u>-</u>	<u>24,208,769</u>	<u>797,609</u>	<u>801,632</u>
<b>With An Allowance Recorded</b>						
Commercial	1,452,798	1,452,798	433,714	1,689,125	14,845	20,748
Agricultural	-	-	-	-	-	-
Commercial Construction	5,922,674	3,471,587	830,546	5,025,176	(159)	-
Commercial Real Estate	5,874,473	5,874,473	423,685	11,072,314	157,536	148,495
Residential Real Estate	1,949,301	1,849,301	526,005	3,661,706	25,739	24,414
Farmland	1,326,982	1,326,982	85,500	663,903	44,638	46,930
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
	<u>16,526,228</u>	<u>13,975,141</u>	<u>2,299,450</u>	<u>22,112,224</u>	<u>242,599</u>	<u>240,587</u>
<b>Total</b>						
Commercial	1,758,070	1,758,070	433,714	1,905,182	39,339	45,941
Agricultural	-	-	-	9,803	-	-
Commercial Construction	13,779,085	8,221,744	830,546	9,130,546	34,749	41,164
Commercial Real Estate	25,994,876	25,127,419	423,685	24,271,302	651,476	651,887
Residential Real Estate	9,786,019	8,210,893	526,005	8,226,372	250,178	233,744
Farmland	1,629,611	1,629,611	85,500	2,522,557	45,441	47,799
Consumer	313,194	307,456	-	252,944	18,469	21,109
Other	9,146	9,146	-	2,287	556	575
	<u>\$53,270,001</u>	<u>\$45,264,339</u>	<u>\$2,299,450</u>	<u>\$46,320,993</u>	<u>\$1,040,208</u>	<u>\$1,042,219</u>



#### (4) Loans (Continued)

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

	<b>Unpaid Contractual Principal Balance</b>	<b>Impaired Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Collected</b>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 1,508,236	\$ 1,041,938	\$ -	\$ 1,052,916	\$ 27,407	\$ 28,410
Agricultural	39,213	39,213	-	58,056	-	-
Commercial Construction	10,624,917	6,414,986	-	9,194,360	27,377	51,820
Commercial Real Estate	16,565,971	15,505,907	-	26,482,274	430,339	420,549
Residential Real Estate	4,450,128	4,131,707	-	3,096,151	89,139	123,101
Farmland	2,828,539	2,413,103	-	2,326,180	42,588	55,258
Consumer	297,356	255,216	-	228,181	10,441	12,920
Other	17,491	17,491	-	24,414	1,191	1,291
	<u>36,331,851</u>	<u>29,819,561</u>	<u>-</u>	<u>42,462,532</u>	<u>628,482</u>	<u>693,349</u>
<b>With An Allowance Recorded</b>						
Commercial	1,493,432	1,493,432	462,555	942,673	91,888	87,611
Agricultural	-	-	-	-	-	-
Commercial Construction	8,266,649	7,617,594	1,732,534	10,533,468	-	-
Commercial Real Estate	12,758,884	12,745,422	1,236,526	6,398,364	383,356	366,423
Residential Real Estate	5,514,994	4,421,809	840,492	4,288,062	144,661	117,266
Farmland	-	-	-	64,862	-	-
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
	<u>28,033,959</u>	<u>26,278,257</u>	<u>4,272,107</u>	<u>22,227,429</u>	<u>619,905</u>	<u>571,300</u>
<b>Total</b>						
Commercial	3,001,668	2,535,370	462,555	1,995,589	119,295	116,021
Agricultural	39,213	39,213	-	58,056	-	-
Commercial Construction	18,891,566	14,032,580	1,732,534	19,727,828	27,377	51,820
Commercial Real Estate	29,324,855	28,251,329	1,236,526	32,880,638	813,695	786,972
Residential Real Estate	9,965,122	8,553,516	840,492	7,384,213	233,800	240,367
Farmland	2,828,539	2,413,103	-	2,391,042	42,588	55,258
Consumer	297,356	255,216	-	228,181	10,441	12,920
Other	17,491	17,491	-	24,414	1,191	1,291
	<u>\$64,365,810</u>	<u>\$56,097,818</u>	<u>\$4,272,107</u>	<u>\$64,689,961</u>	<u>\$1,248,387</u>	<u>\$1,264,649</u>

#### **(4) Loans (Continued)**

Troubled Debt Restructurings (TDRs) are troubled loans on which the original terms of the loan have been modified in favor of the borrower due to deterioration in the borrower's financial condition. Each potential loan modification is reviewed individually and the terms of the loan are modified to meet the borrower's specific circumstances at a point in time. Not all loan modifications are TDRs. Loan modifications are reviewed and approved by the Company's senior lending staff, who then determine whether the loan meets the criteria for a TDR. Generally, the types of concessions granted to borrowers that are evaluated in determining whether a loan is classified as a TDR include:

- Interest rate reductions - Occur when the stated interest rate is reduced to a nonmarket rate or a rate the borrower would not be able to obtain elsewhere under similar circumstances.
- Amortization or maturity date changes - Result when the amortization period of the loan is extended beyond what is considered a normal amortization period for loans of similar type with similar collateral.
- Principal reductions - These are often the result of commercial real estate loan workouts where two new notes are created. The primary note is underwritten based upon our normal underwriting standards and is structured so that the projected cash flows are sufficient to repay the contractual principal and interest of the newly restructured note. The terms of the secondary note vary by situation and often involve that note being charged off, or the principal and interest payments being deferred until after the primary note has been repaid. In situations where a portion of the note is charged off during modification, there is often no specific reserve allocated to those loans. This is due to the fact that the amount of the charge-off usually represents the excess of the original loan balance over the collateral value and the Company has determined there is no additional exposure on those loans.

#### (4) Loans (Continued)

As discussed in Note 1, Summary of Significant Accounting Policies, once a loan is identified as a TDR, it is accounted for as an impaired loan. The Company had no unfunded commitments to lend to a customer that has a troubled debt restructured loan as of December 31, 2013. The following tables present the number of loan contracts restructured during the 12 months ended December 31, 2013 and the pre- and post-modification recorded investment as well as the number of contracts and the recorded investment for those TDRs modified during the previous 12 months which subsequently defaulted during the period. Loans modified in a troubled debt restructuring are considered to be in default once the loan becomes 90 days past due.

#### Troubled Debt Restructurings

<b>2013</b>	<b><u># of Contracts</u></b>	<b><u>Pre-Modification</u></b>	<b><u>Post-Modification</u></b>
Commercial	<b>1</b>	<b>\$ 83,748</b>	<b>\$ 81,277</b>
Commercial Construction	<b>2</b>	<b>228,633</b>	<b>225,959</b>
Commercial Real Estate	<b>1</b>	<b>225,852</b>	<b>225,852</b>
Residential Real Estate	<b>4</b>	<b>1,885,700</b>	<b>1,764,399</b>
<b>Total Loans</b>	<b>8</b>	<b>\$2,423,933</b>	<b>\$2,297,487</b>
2012			
Commercial	1	\$ 107,749	\$ 107,749
Commercial Real Estate	1	56,835	56,835
Residential Real Estate	5	1,082,585	1,079,614
<b>Total Loans</b>	<b>7</b>	<b>\$ 1,247,169</b>	<b>\$ 1,244,198</b>
2011			
Commercial	3	\$ 3,240,469	\$ 1,541,882
Commercial Construction	3	1,430,147	1,430,101
Commercial Real Estate	9	20,827,349	15,906,547
Residential Real Estate	8	1,505,356	1,456,878
<b>Total Loans</b>	<b>23</b>	<b>\$27,003,321</b>	<b>\$20,335,408</b>

#### (4) Loans (Continued)

Troubled debt restructurings that subsequently defaulted as of December 31 are as follows:

	2013		2012		2011	
	<u># of Contracts</u>	<u>Recorded Investment</u>	<u># of Contracts</u>	<u>Recorded Investment</u>	<u># of Contracts</u>	<u>Recorded Investment</u>
Commercial	1	\$ 81,277	-	\$ -	1	\$ 1,175,922
Commercial Construction	-	-	-	-	3	4,475,473
Commercial Real Estate	-	-	1	203,291	3	2,322,361
Residential Real Estate	-	-	1	10,000	-	-
<b>Total Loans</b>	<u>1</u>	<u>\$ 81,277</u>	<u>2</u>	<u>\$ 213,291</u>	<u>7</u>	<u>\$7,973,756</u>

At December 31, 2013, 2012 and 2011, all restructured loans were performing as agreed. However, two restructured loans totaling \$81,277 and \$10,000 at December 31, 2013 and 2012 failed to continue to perform as agreed and, as a result, the loans were charged off in August 2013 and January 2012, respectively. At December 31, 2011, two restructured loans totaling \$999,133 and \$51,998 failed to continue to perform as agreed and, as a result, the loans were charged off in March 2011 and December 2011, respectively.

#### (5) Allowance for Loan Losses

Changes in the allowance for loan losses for the years ended December 31 are as follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>Balance, Beginning of Year</b>	<b>\$ 12,736,921</b>	\$ 15,649,594	\$ 28,280,077
Provision for Loan Losses	<b>4,485,000</b>	6,784,767	8,250,000
Loans Charged Off	<b>(6,227,716)</b>	(10,454,175)	(22,850,673)
Recoveries of Loans Previously Charged Off	<b>811,781</b>	756,735	1,970,190
<b>Balance, End of Year</b>	<b>\$ 11,805,986</b>	<b>\$ 12,736,921</b>	<b>\$ 15,649,594</b>

## (5) Allowance for Loan Losses (Continued)

The following tables detail activity in the allowance for loan losses, segregated by class of loan, for the years ended December 31. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other loan categories and periodically may result in reallocation within the provision categories.

2013	<u>Beginning Balance</u>	<u>Charge-Offs</u>	<u>Recoveries</u>	<u>Provision</u>	<u>Ending Balance</u>
<b>Commercial and Agricultural</b>					
Commercial	\$ 981,021	\$ (120,690)	\$ 55,829	\$ 100,913	\$ 1,017,073
Agricultural	296,175	(34,502)	6,200	26,013	293,886
<b>Real Estate</b>					
Commercial Construction	1,890,200	(2,071,162)	253,459	1,709,682	1,782,179
Residential Construction	138,092	-	-	-	138,092
Commercial	5,162,839	(2,872,408)	297,984	1,790,861	4,379,276
Residential	3,405,947	(706,242)	64,583	513,981	3,278,269
Farmland	290,526	(20,977)	21,762	20,183	311,494
<b>Consumer and Other</b>					
Consumer	227,774	(397,822)	93,520	319,781	243,253
Other	344,347	(3,913)	18,444	3,586	362,464
	<u>\$12,736,921</u>	<u>\$(6,227,716)</u>	<u>\$811,781</u>	<u>\$4,485,000</u>	<u>\$11,805,986</u>
2012					
<b>Commercial and Agricultural</b>					
Commercial	\$ 1,070,560	\$ (653,389)	\$ 139,802	\$ 424,048	\$ 981,021
Agricultural	297,168	(3,028)	-	2,035	296,175
<b>Real Estate</b>					
Commercial Construction	3,122,594	(4,106,124)	209,352	2,664,378	1,890,200
Residential Construction	138,092	-	-	-	138,092
Commercial	6,448,064	(4,325,642)	232,880	2,807,537	5,162,839
Residential	3,695,357	(960,620)	47,690	623,520	3,405,947
Farmland	364,663	(224,725)	4,716	145,872	290,526
<b>Consumer and Other</b>					
Consumer	205,154	(169,249)	81,956	109,913	227,774
Other	307,942	(11,398)	40,339	7,464	344,347
	<u>\$15,649,594</u>	<u>\$(10,454,175)</u>	<u>\$ 756,735</u>	<u>\$6,784,767</u>	<u>\$12,736,921</u>

**(5) Allowance for Loan Losses (Continued)**

2011	<b>Beginning Balance</b>	<b>Charge-Offs</b>	<b>Recoveries</b>	<b>Provision</b>	<b>Ending Balance</b>
<b>Commercial and Agricultural</b>					
Commercial	\$ 4,414,817	\$ (841,887)	\$ 127,490	\$(2,629,860)	\$ 1,070,560
Agricultural	698,637	(455,165)	454,453	(400,757)	297,168
<b>Real Estate</b>					
Commercial Construction	4,126,043	(6,957,181)	557,168	5,396,564	3,122,594
Residential Construction	519,766	(481)	-	(381,193)	138,092
Commercial	8,029,525	(12,492,097)	527,996	10,382,640	6,448,064
Residential	5,941,696	(1,704,887)	149,173	(690,625)	3,695,357
Farmland	944,323	(60,447)	411	(519,624)	364,663
<b>Consumer and Other</b>					
Consumer	3,074,220	(222,878)	145,279	(2,791,467)	205,154
Other	531,050	(115,650)	8,220	(115,678)	307,942
	<u>\$28,280,077</u>	<u>\$(22,850,673)</u>	<u>\$1,970,190</u>	<u>\$ 8,250,000</u>	<u>\$15,649,594</u>

During 2012, the Company changed its loss history period used in calculating the ALLL from a one-year average to a rolling eight-quarter average. Although at December 31, 2012 the loss history period used was based on the annual loss rate from calendar year 2011 and the first three quarters of 2012, whereas the loss history period used at December 31, 2013 was based on the loss rate from the eight quarters ended September 30, 2013.

During the third quarter, management implemented a change to its methodology for calculating the allowance for loan losses. This change was intended to better reflect the current position of the loan portfolio. Prior to the third quarter, the allowance for loan loss calculation incorporated a qualitative factor related to improvements in credit administration. These improvements, which began in 2008, included organizational changes to credit administration, specifically related to managing past due loans, grading of loans, recognition of losses and underwriting of new loans. Primary among the organizational changes was the appointment of experienced lending officers to oversee the lending function, as well as the appointment of a chief credit officer. Management feels these organizational changes are now fully implemented, as evidenced by a lower charge-off rate, and therefore, the qualitative factor is no longer relevant. The removal of this qualitative factor did not result in a significant adjustment to the recorded allowance for loan loss balance.

The Company determines its individual reserves during its quarterly review of substandard loans. This process involves reviewing all loans with a risk grade of 6 or greater and an outstanding balance of \$250,000 or more, regardless of the loans impairment classification. Effective March 31, 2013, management increased the dollar threshold of this review process from \$50,000 to \$250,000. The threshold change resulted in loans totaling \$4.1 million at December 31, 2013 being removed from the individual impairment review process and being placed in the collective review process. These loans are now subject to general reserves.

## (5) Allowance for Loan Losses (Continued)

Since not all loans in the substandard category are considered impaired, this quarterly review process may result in the identification of specific reserves on nonimpaired loans. Management considers those loans graded substandard, but not classified as impaired, to be higher risk loans and, therefore, makes specific allocations to the allowance for those loans if warranted. The total of such loans is \$6.7 million and \$10.8 million as of December 31, 2013 and 2012, respectively. Specific allowance allocations were made for these loans totaling \$261 thousand and \$899 thousand as of December 31, 2013 and 2012, respectively. Since these loans are not considered impaired, both the loan balance and related specific allocation are included in the “Collectively Evaluated for Impairment” column of the following tables.

At December 31, 2013, impaired loans totaling \$2.82 million were below the \$250 thousand review threshold and were not individually reviewed for impairment. Those loans were subject to the bank’s general loan loss reserve methodology and are included in the “Collectively Evaluated for Impairment” column of the following tables. Likewise, at December 31, 2012 and 2011, impaired loans totaling \$1.03 million and \$995 thousand, respectively, were below the \$50 thousand review threshold and were subject to the bank’s general loan loss reserve methodology and are included in the “Collectively Evaluated for Impairment” column of the following tables.

2013	Ending Allowance Balance			Ending Loan Balance		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
<b>Commercial and Agricultural</b>						
Commercial	\$ 433,714	\$ 583,359	\$ 1,017,073	\$ 1,542,058	\$ 46,565,390	\$ 48,107,448
Agricultural	-	293,886	293,886	-	10,665,938	10,665,938
<b>Real Estate</b>						
Commercial Construction	830,546	951,633	1,782,179	7,971,298	44,767,485	52,738,783
Residential Construction	-	138,092	138,092	-	6,549,260	6,549,260
Commercial	423,685	3,955,591	4,379,276	24,757,942	317,025,596	341,783,538
Residential	526,005	2,752,264	3,278,269	6,545,490	199,712,437	206,257,927
Farmland	85,500	225,994	311,494	1,617,206	45,417,220	47,034,426
<b>Consumer and Other</b>						
Consumer	-	243,253	243,253	-	25,675,560	25,675,560
Other	-	362,464	362,464	9,146	12,396,436	12,405,582
<b>Total End of Year Balance</b>	<b>\$2,299,450</b>	<b>\$9,506,536</b>	<b>\$11,805,986</b>	<b>\$42,443,140</b>	<b>\$708,775,322</b>	<b>\$751,218,462</b>

**(5) Allowance for Loan Losses (Continued)**

2012	Ending Allowance Balance			Ending Loan Balance		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
<b>Commercial and Agricultural</b>						
Commercial	\$ 462,555	\$ 518,466	\$ 981,021	\$ 2,512,133	\$ 53,172,359	\$ 55,684,492
Agricultural	-	296,175	296,175	-	6,210,953	6,210,953
<b>Real Estate</b>						
Commercial Construction	1,732,534	157,666	1,890,200	13,892,135	39,915,921	53,808,056
Residential Construction	-	138,092	138,092	-	5,852,238	5,852,238
Commercial	1,236,526	3,926,313	5,162,839	28,205,405	306,180,772	334,386,177
Residential	840,492	2,565,455	3,405,947	8,022,249	195,822,273	203,844,522
Farmland	-	290,526	290,526	2,393,775	46,663,086	49,056,861
<b>Consumer and Other</b>						
Consumer	-	227,774	227,774	28,007	29,749,769	29,777,776
Other	-	344,347	344,347	17,491	8,411,445	8,428,936
<b>Total End of Year Balance</b>	<b>\$4,272,107</b>	<b>\$8,464,814</b>	<b>\$12,736,921</b>	<b>\$55,071,195</b>	<b>\$691,978,816</b>	<b>\$747,050,011</b>

2011	Ending Allowance Balance			Ending Loan Balance		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
<b>Commercial and Agricultural</b>						
Commercial	\$ 308,211	\$ 762,349	\$ 1,070,560	\$ 2,237,878	\$ 46,748,224	\$ 48,986,102
Agricultural	-	297,168	297,168	-	8,421,884	8,421,884
<b>Real Estate</b>						
Commercial Construction	2,693,571	429,023	3,122,594	24,212,519	34,333,301	58,545,820
Residential Construction	-	138,092	138,092	-	3,530,502	3,530,502
Commercial	2,060,815	4,387,249	6,448,064	35,715,026	279,565,722	315,280,748
Residential	674,998	3,020,359	3,695,357	5,614,744	188,023,073	193,637,817
Farmland	11,878	352,785	364,663	486,683	47,738,723	48,225,406
<b>Consumer and Other</b>						
Consumer	1,632	203,522	205,154	9,596	30,439,707	30,449,303
Other	-	307,942	307,942	-	9,243,739	9,243,739
<b>Total End of Year Balance</b>	<b>\$ 5,751,105</b>	<b>\$ 9,898,489</b>	<b>\$15,649,594</b>	<b>\$ 68,276,446</b>	<b>\$648,044,875</b>	<b>\$716,321,321</b>



## (6) Premises and Equipment

Premises and equipment are comprised of the following as of December 31:

	<u>2013</u>	<u>2012</u>
Land	\$ 7,790,167	\$ 7,780,167
Building	23,832,454	23,758,761
Furniture, Fixtures and Equipment	13,846,579	12,923,699
Leasehold Improvements	970,346	948,260
Construction in Progress	236,591	-
	<u>46,676,137</u>	45,410,887
Accumulated Depreciation	<u>(21,799,668)</u>	<u>(20,494,781)</u>
	<u>\$ 24,876,469</u>	<u>\$ 24,916,106</u>

Depreciation charged to operations totaled \$1,527,392 in 2013, \$1,676,820 in 2012 and \$1,790,041 in 2011.

Certain Company facilities and equipment are leased under various operating leases. Rental expense approximated \$490,000 for 2013, \$447,000 for 2012 and \$376,000 for 2011.

Future minimum rental payments as of December 31, 2013 are as follows:

<u>Year Ending December 31</u>	<u>Amount</u>
2014	\$ 53,458
2015	42,000
2016	42,000
2017	38,500
	<u>\$175,958</u>

## (7) Other Real Estate Owned

The aggregate carrying amount of Other Real Estate Owned (OREO) at December 31, 2013, 2012 and 2011 was \$15,502,462, \$15,940,693 and \$20,445,805, respectively. All of the Company's other real estate owned represents properties acquired through foreclosure or deed in lieu of foreclosure. The following table details the change in OREO during 2013, 2012 and 2011 as of December 31:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>Balance, Beginning of Year</b>	<b>\$15,940,693</b>	\$20,445,085	\$20,207,806
Additions	10,251,006	9,729,174	12,555,622
Sales of OREO	(7,804,080)	(9,711,890)	(9,804,669)
Loss on Sale	(1,563,739)	(1,818,967)	(1,102,613)
Provision for Losses	(1,321,418)	(2,702,709)	(1,411,061)
<b>Balance, End of Year</b>	<b>\$15,502,462</b>	<b>\$15,940,693</b>	<b>\$20,445,085</b>

## (8) Intangible Assets

The following is an analysis of the core deposit intangible activity for the years ended December 31:

	<u>Core Deposit Intangible</u>	<u>Accumulated Amortization</u>	<u>Net Core Deposit Intangible</u>
<b>Core Deposit Intangible</b>			
Balance, December 31, 2011	\$1,056,693	\$(797,435)	\$ 259,258
Amortization Expense	-	(35,748)	(35,748)
Balance, December 31, 2012	1,056,693	(833,183)	223,510
Amortization Expense	-	(35,749)	(35,749)
<b>Balance, December 31, 2013</b>	<b><u>\$1,056,693</u></b>	<b><u>\$(868,932)</u></b>	<b><u>\$ 187,761</u></b>

Amortization expense related to the core deposit intangible was \$35,749, \$35,748 and \$35,749 for the years ended December 31, 2013, 2012 and 2011. Amortizations expense will continue at an annual rate of approximately \$35,749 through the first quarter of 2019, at which point the core deposit will be fully amortized.

## (9) Income Taxes

The components of income tax (benefit) expense for the years ended December 31 are as follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Current Federal (Benefit) Expense	\$ 156,642	\$ (6,114)	\$ 311,174
Deferred Federal (Benefit) Expense	<u>2,178,222</u>	<u>1,204,439</u>	<u>867,006</u>
Federal Income Tax (Benefit) Expense	2,334,864	1,198,325	1,178,180
Current State Income Tax (Benefit) Expense	-	2,526	(74,297)
	<b><u>\$2,334,864</u></b>	<b><u>\$1,200,851</u></b>	<b><u>\$1,103,883</u></b>

The federal income tax (benefit) expense of \$2,334,864 in 2013, \$1,198,325 in 2012 and \$1,178,180 in 2011 is different than the income taxes computed by applying the federal statutory rates to income before income taxes. The reasons for the differences are as follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>Statutory Federal Income Taxes</b>	<b>\$2,367,729</b>	<b>\$1,306,331</b>	<b>\$1,228,538</b>
Tax-Exempt Interest	(110,752)	(94,891)	(126,468)
Interest Expense Disallowance	6,445	4,908	8,751
Premiums on Officers' Life Insurance	(111,749)	(59,603)	(52,431)
Meal and Entertainment Disallowance	26,549	25,567	20,693
Other	156,642	16,013	99,097
<b>Actual Federal Income Taxes</b>	<b><u>\$2,334,864</u></b>	<b><u>\$1,198,325</u></b>	<b><u>\$1,178,180</u></b>

## (9) Income Taxes (Continued)

Deferred taxes in the accompanying consolidated balance sheets as of December 31 include the following:

	<u>2013</u>	<u>2012</u>
<b>Deferred Tax Assets</b>		
Allowance for Loan Losses	\$ 4,014,035	\$ 4,330,553
Other Real Estate	1,404,812	1,668,653
Deferred Compensation	303,380	342,547
Investments	340,000	-
Goodwill	301,238	345,762
Net Operating Loss Carryforward	730,484	2,310,708
Other	343,919	529,706
	<u>7,437,868</u>	<u>9,527,929</u>
<b>Deferred Tax Liabilities</b>		
Premises and Equipment	(1,322,377)	(1,232,905)
Other	(2,874)	(4,185)
	<u>(1,325,251)</u>	<u>(1,237,090)</u>
<b>Deferred Tax Assets (Liabilities) on Unrealized Securities Gains (Losses)</b>	<u>4,550,362</u>	<u>77,177</u>
<b>Net Deferred Tax Assets</b>	<u><u>\$10,662,979</u></u>	<u><u>\$ 8,368,016</u></u>

The deferred tax assets are included in Other Assets in the consolidated balance sheets. As discussed in Note 1, certain positions taken in the Company's tax returns may be subject to challenge by the taxing authorities. An analysis of activity related to unrecognized taxes as of December 31 follows.

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>Balance, Beginning</b>	\$ 38,676	\$ 33,368	\$ 78,121
Positions Taken During the Current Year	7,247	11,794	14,275
Reductions Resulting from Lapse of Statutes of Limitation	(3,596)	(6,486)	(59,028)
<b>Balance, Ending</b>	<u><u>\$ 42,327</u></u>	<u><u>\$ 38,676</u></u>	<u><u>\$ 33,368</u></u>

The net increase of \$3,651 and \$5,308 is included in income tax expense for the years ended December 31, 2013 and 2012, respectively.

The Company has cumulative federal net operating loss carryforwards of \$2,148,335 at December 31, 2013 that expire beginning in 2022.

## (10) Deposits

The aggregate amount of overdrawn deposit accounts reclassified as loan balances totaled \$400,552 and \$389,331 as of December 31, 2013 and 2012, respectively.

Components of interest-bearing deposits as of December 31 are as follows:

	<u>2013</u>	<u>2012</u>
Interest-Bearing Demand	<b>\$357,290,975</b>	\$314,030,843
Savings	<b>54,094,617</b>	48,777,743
Time, \$100,000 and Over	<b>220,672,794</b>	211,244,750
Other Time	<b>240,210,393</b>	281,665,013
	<b><u>\$872,268,779</u></b>	<b><u>\$855,718,349</u></b>

At December 31, 2013 and 2012, the Company had brokered deposits of \$26,579,934 and \$28,229,608, respectively. Of the brokered deposits at December 31, 2013 and 2012, \$26,579,934 and \$28,229,608 represented Certificate of Deposits Account Registry Service (CDARS) reciprocal deposits in which customers placed core deposits into the CDARS program for FDIC insurance coverage and the Company received reciprocal brokered deposits in a like amount. Thus, brokered deposits less the reciprocal deposits totaled \$0 at December 31, 2013 and 2012. The aggregate amount of short-term jumbo certificates of deposit, each with a minimum denomination of \$100,000, was approximately \$143,388,694 and \$161,530,500 as of December 31, 2013 and 2012, respectively.

As of December 31, 2013, the scheduled maturities of certificates of deposit are as follows:

<u>Year</u>	<u>Amount</u>
2014	\$322,971,106
2015	69,000,752
2016	37,944,799
2017	12,974,997
2018 and Thereafter	17,991,533
	<b><u>\$460,883,187</u></b>

## (11) Other Borrowed Money

Other borrowed money at December 31 is summarized as follows:

	<u>2013</u>	<u>2012</u>
Federal Home Loan Bank Advances	<b><u>\$ 40,000,000</u></b>	<b><u>\$ 35,000,000</u></b>

Advances from the Federal Home Loan Bank (FHLB) have maturities ranging from 2017 to 2020 and interest rates ranging from 0.49 percent to 4.75 percent. As collateral on the outstanding FHLB advances, the Company has provided a blanket lien on its portfolio of qualifying residential first mortgage loans and commercial loans. At December 31, 2013, the book value of those loans pledged approximated \$90,000,000. At December 31, 2013, the Company had remaining credit availability from the FHLB of approximately \$126,490,000. The Company may be required to pledge additional qualifying collateral in order to utilize the full amount of the remaining credit line.

## (11) Other Borrowed Money (Continued)

Other borrowed money of \$9,000,000 matures in 2017, with the remainder of \$31,000,000 maturing in 2018 and thereafter. At December 31, 2013, \$30,000,000 of FHLB advances are subject to fixed rates of interest, while the remaining \$10,000,000 are subject to floating interest rates which will convert to fixed rates of interests after two years.

The Company also has available federal funds lines of credit with various financial institutions totaling \$43,000,000, of which there were none outstanding at December 31, 2013.

The Company has the ability to borrow funds from the Federal Reserve Bank (FRB) of Atlanta utilizing the discount window. The discount window is an instrument of monetary policy that allows eligible institutions to borrow money from the FRB on a short-term basis to meet temporary liquidity shortages caused by internal or external disruptions. At December 31, 2013, the Company had borrowing capacity available under this arrangement, with no outstanding balances. The Company would be required to pledge certain available-for-sale investment securities as collateral under this agreement.

In addition, at December 31, 2013, the Company had an available repurchase agreement line of credit with a third party totaling \$50,000,000. Use of this credit facility is subject to the underwriting and risk management policies of the third party in effect at the time of the request. Such policies may take into consideration current market conditions, the current financial condition of the Company and the ability of the Company to provide adequate securities as collateral for the transaction, among other factors.

## (12) Subordinated Debentures (Trust Preferred Securities)

Description	Date	Amount	3-Month Libor Rate	Added Points	Total Interest Rate	Maturity	5-Year Call Option
(In Thousands)							
Colony Bankcorp Statutory Trust III	6/17/2004	\$4,640	0.24385	2.68	2.92385	6/14/2034	6/17/2009
Colony Bankcorp Capital Trust I	4/13/2006	5,155	0.24660	1.50	1.74660	4/13/2036	4/13/2011
Colony Bankcorp Capital Trust II	3/12/2007	9,279	0.24685	1.65	1.89685	3/12/2037	3/12/2012
Colony Bankcorp Capital Trust III	9/14/2007	5,155	0.23585	1.40	1.63585	9/14/2037	9/14/2012

The Trust Preferred Securities are recorded as subordinated debentures on the consolidated balance sheets, but subject to certain limitations, qualify as Tier 1 Capital for regulatory capital purposes. The proceeds from these offerings were used to fund certain acquisitions, pay off holding Company debt and inject capital into the bank subsidiary.

On February 13, 2012, the Company announced the suspension of the quarterly interest payments on the Trust Preferred Securities. Under the terms of the trust documents, the Company may defer payments of interest for up to 20 consecutive quarterly periods without default or penalty. The regularly scheduled interest payments will continue to be accrued for payment in the future and reported as an expense in the current period. At December 31, 2013, accrued but unpaid interest expense totaled \$1,069,769.

### **(13) Preferred Stock**

On January 9, 2009 the Company received \$28.0 million of equity capital by issuing to the United States Department of the Treasury (Treasury) 28,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Preferred Stock) and a warrant (the Warrant) to purchase up to 500,000 shares of the Company's common stock. The Preferred stock qualifies as Tier 1 capital and is nonvoting, other than class voting rights on certain matters that could adversely affect the Preferred Stock. The Preferred Stock may be redeemed by the Company at the liquidation preference of \$1,000 per share, plus any accrued and unpaid dividends. The Warrant may be exercised on or before January 9, 2019 at an exercise price of \$8.40 per share. No voting rights may be exercised with respect to the shares of the Warrant until the Warrant has been exercised.

On January 29, 2013, the Company's 28,000 shares of Preferred Stock was sold by the Treasury to the public through an auction. On June 5, 2013, the Company's Warrant for 500,000 shares of common stock was also sold by the Treasury to the public through an auction. Neither the sale of the Preferred Stock nor the sale of the Warrant to new investors resulted in any accounting entries and neither transaction had an impact on the Company's capital position.

The Preferred Stock requires a cumulative cash dividend be paid quarterly at a rate of 5 percent per annum for the first five years and at 9 percent per annum thereafter. On February 13, 2012, the Company announced the suspension of dividends on Preferred Stock. Unpaid dividends on the Preferred Stock must be declared and set aside for the benefit of the holders of the Preferred Stock before any dividend may be declared on common stock. At December 31, 2013 there were accumulated dividends in arrears of \$3.12 million, approximately \$111 per share, including accrued interest. Beginning January 9, 2014, cumulated dividends on the Preferred Shares will continue to accrue at a rate of 9 percent per annum.

### **(14) Restricted Stock - Unearned Compensation**

In April 2004, the stockholders of Colony Bankcorp, Inc. adopted a restricted stock grant plan which awards certain executive officers common shares of the Company. The maximum number of shares which may be subject to restricted stock awards (split-adjusted) is 143,500. To date, 53,256 shares have been issued under this plan and 17,798 shares have been forfeited; thus, the remaining shares which may be issued are 108,042 at December 31, 2013. During 2013, there were no shares of restricted stock issued or forfeited. The shares are recorded at fair market value (on the date granted) as a separate component of stockholders' equity. The cost of the shares, when issued, is amortized against earnings using the straight-line method over the restriction period, typically three years.

### **(15) Employee Benefit Plan**

The Company offers a defined contribution 401(k) Profit Sharing Plan (the Plan) which covers substantially all employees who meet certain age and service requirements. The Plan allows employees to make voluntary pre-tax salary deferrals to the Plan. The Company, at its discretion, may elect to make an annual contribution to the Plan equal to a percentage of each participating employee's salary. Such discretionary contributions must be approved by the Company's board of directors. Employees are fully vested in the Company contributions after six years of service. The Company made no discretionary contributions in 2013, 2012 or 2011.

## (16) Commitments and Contingencies

*Credit-Related Financial Instruments.* The Company is a party to credit-related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments.

At December 31, 2013 and 2012, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<b>Contract Amount</b>	
	<b>2013</b>	<b>2012</b>
Commitments to Extend Credit	<b>\$65,688,000</b>	\$64,147,000
Standby Letters of Credit	<b>1,411,000</b>	1,141,000

Commitments to extend credit are agreements to lend to a customer as 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. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

Standby and performance letters of credit are conditional lending commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

*Legal Contingencies.* In the ordinary course of business, there are various legal proceedings pending against Colony and its subsidiary. The aggregate liabilities, if any, arising from such proceedings would not, in the opinion of management, have a material adverse effect on Colony's consolidated financial position.

## (17) Deferred Compensation Plan

Colony Bank, the wholly-owned subsidiary, has deferred compensation plans covering certain former directors and certain officers choosing to participate through individual deferred compensation contracts. In accordance with terms of the contracts, the Bank is committed to pay the participant's deferred compensation over a specified number of years, beginning at age 65. In the event of a participant's death before age 65, payments are made to the participant's named beneficiary over a specified number of years, beginning on the first day of the month following the death of the participant.

Liabilities accrued under the plans totaled \$892,294 and \$1,007,490 as of December 31, 2013 and 2012, respectively. Benefit payments under the contracts were \$188,240 in 2013 and \$203,904 in 2012. Provisions charged to operations totaled \$75,777 in 2013, \$82,250 in 2012 and \$98,901 in 2011.

Fee income recognized with deferred compensation plans totaled \$164,073 in 2013, \$175,302 in 2012 and \$154,210 in 2011.

## (18) Supplemental Cash Flow Information

Cash payments for the following were made during the years ended December 31:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Interest Expense	<u>\$ 7,111,361</u>	<u>\$10,942,113</u>	<u>\$17,204,476</u>
Income Taxes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 390,152</u>

Noncash financing and investing activities for the years ended December 31 are as follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Acquisitions of Real Estate Through Loan Foreclosures	<u>\$10,251,006</u>	<u>\$ 9,729,174</u>	<u>\$12,555,622</u>
Unrealized (Gain) Loss on Investment Securities	<u>\$13,523,049</u>	<u>\$ 3,120,540</u>	<u>\$ (3,802,320)</u>

## (19) Related Party Transactions

The following table reflects the activity and aggregate balance of direct and indirect loans to directors, executive officers or principal holders of equity securities of the Company. All such loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and do not involve more than a normal risk of collectibility. A summary of activity of related party loans is shown below:

	<u>2013</u>	<u>2012</u>
<b>Balance, Beginning</b>	<b>\$ 4,776,492</b>	<b>\$ 5,504,230</b>
New Loans	<b>7,610,259</b>	8,075,835
Repayments	<b>(8,322,163)</b>	(10,510,517)
Transactions Due to Changes in Directors	<u>-</u>	<u>1,706,944</u>
<b>Balance, Ending</b>	<b><u>\$ 4,064,588</u></b>	<b><u>\$ 4,776,492</u></b>



## **(20) Fair Value of Financial Instruments and Fair Value Measurements**

Generally accepted accounting standards in the U.S. require disclosure of fair value information about financial instruments, whether or not recognized on the face of the balance sheet, for which it is practicable to estimate that value. The assumptions used in the estimation of the fair value of Colony Bankcorp, Inc. and Subsidiary's financial instruments are detailed hereafter. Where quoted prices are not available, fair values are based on estimates using discounted cash flows and other valuation techniques. The use of discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following disclosures should not be considered a surrogate of the liquidation value of the Company, but rather a good-faith estimate of the increase or decrease in value of financial instruments held by the Company since purchase, origination or issuance.

**Cash and Short-Term Investments** - For cash, due from banks, bank-owned deposits and federal funds sold, the carrying amount is a reasonable estimate of fair value and is classified level 1.

**Investment Securities** - Fair values for investment securities are based on quoted market prices where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments. If a comparable is not available, the investment securities are classified as level 3.

**Federal Home Loan Bank Stock** - The fair value of Federal Home Loan Bank stock approximates carrying value.

**Loans** - The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings. For variable rate loans, the carrying amount is a reasonable estimate of fair value.

**Bank-Owned Life Insurance** - The carrying value of bank-owned life insurance policies approximates fair value.

**Deposit Liabilities** - The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date and is classified as level 1. The fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities and is classified as level 2.

**Subordinated Debentures** - Fair value approximates carrying value due to the variable interest rates of the subordinated debentures.

**Other Borrowed Money** - The fair value of other borrowed money is calculated by discounting contractual cash flows using an estimated interest rate based on current rates available to the Company for debt of similar remaining maturities and collateral terms. Other borrowed money is classified as level 2 due to their expected maturities.

## (20) Fair Value of Financial Instruments and Fair Value Measurements (Continued)

The carrying amount and estimated fair values of the Company's financial instruments as of December 31 are as follows:

2013	Carrying Amount	Estimated Fair Value	Level		
			1	2	3
(in Thousands)					
<b>Assets</b>					
Cash and Short-Term Investments	\$ 68,147	\$ 68,147	\$ 68,147	\$ -	\$ -
Investment Securities Available for Sale	263,258	263,258	-	262,317	941
Investment Securities Held to Maturity	37	37	-	37	-
Federal Home Loan Bank Stock	3,164	3,164	3,164	-	-
Loans, Net	739,052	741,112	-	729,436	11,676
Bank-Owned Life Insurance	10,165	10,165	10,165	-	-
<b>Liabilities</b>					
Deposits	987,529	989,101	526,646	462,455	-
Subordinated Debentures	24,229	24,229	24,229	-	-
Other Borrowed Money	40,000	42,074	-	42,074	-
2012					
<b>Assets</b>					
Cash and Short-Term Investments	\$ 71,041	\$ 71,041	\$ 71,041	\$ -	\$ -
Investment Securities Available for Sale	268,300	268,300	-	267,162	1,138
Investment Securities Held to Maturity	41	42	-	42	-
Federal Home Loan Bank Stock	3,364	3,364	3,364	-	-
Loans, Net	734,079	735,115	-	713,109	22,006
<b>Liabilities</b>					
Deposits	979,685	982,215	486,775	495,440	-
Subordinated Debentures	24,229	24,229	24,229	-	-
Other Borrowed Money	35,000	38,424	-	38,424	-

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on many judgments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial instruments include deferred income taxes and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

## **(20) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

### **Fair Value Measurements**

Generally accepted accounting principles related to *Fair Value Measurements* define fair value, establish a framework for measuring fair value, establish a three-level valuation hierarchy for disclosure of fair value measurement and enhance disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 inputs to the valuation methodology are unobservable and represent the Company's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring and nonrecurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy:

#### ***Assets***

*Securities* - Where quoted prices are available in an active market, securities are classified within level 1 of the valuation hierarchy. Level 1 inputs include securities that have quoted prices in active markets for identical assets. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Examples of such instruments, which would generally be classified within level 2 of the valuation hierarchy, include certain collateralized mortgage and debt obligations and certain high-yield debt securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within level 3 of the valuation hierarchy. When measuring fair value, the valuation techniques available under the market approach, income approach and/or cost approach are used. The Company's evaluations are based on market data and the Company employs combinations of these approaches for its valuation methods depending on the asset class.

## **(20) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

### **Fair Value Measurements**

*Impaired Loans* - Impaired loans are those loans which the Company has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

*Other Real Estate* - Other real estate owned assets are adjusted to fair value less estimated selling costs upon transfer of the loans to other real estate owned. Typically, an external, third-party appraisal is performed on the collateral upon transfer into the other real estate owned account to determine the asset's fair value. Subsequent adjustments to the collateral's value may be based upon either updated third-party appraisals or management's knowledge of the collateral and the current real estate market conditions. Appraised amounts used in determining the asset's fair value, whether internally or externally prepared, are discounted 10 percent to account for selling and marketing costs. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a level 3 classification of the inputs for determining fair value. Because of the high degree of judgment required in estimating the fair value of other real estate owned assets and because of the relationship between fair value and general economic conditions, we consider the fair value of other real estate owned assets to be highly sensitive to changes in market conditions.

## (20) Fair Value of Financial Instruments and Fair Value Measurements (Continued)

### Fair Value Measurements (Continued)

#### Assets (Continued)

*Assets and Liabilities Measured at Fair Value on a Recurring and Nonrecurring Basis* - The following table presents the recorded amount of the Company's assets measured at fair value on a recurring and nonrecurring basis as of December 31, 2013 and 2012, aggregated by the level in the fair value hierarchy within which those measurements fall. The table below includes only impaired loans with a specific reserve and only other real estate properties with a valuation allowance at December 31, 2013. Those impaired loans and other real estate properties are shown net of the related specific reserves and valuation allowances.

	2013	Fair Value Measurements at Reporting Date Using		
		Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
<b>Recurring</b>				
<b>Securities Available for Sale</b>				
U.S. Government Agencies				
Mortgage-Backed	\$259,348,058	\$ -	\$259,348,058	\$ -
State, County and Municipal	3,909,832	-	2,968,567	941,265
	<u>\$263,257,890</u>	<u>\$ -</u>	<u>\$262,316,625</u>	<u>941,265</u>
<b>Nonrecurring</b>				
Impaired Loans	<u>\$ 11,675,691</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 11,675,691</u>
Other Real Estate	<u>\$ 7,019,799</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,019,799</u>
	2012			
<b>Recurring</b>				
<b>Securities Available for Sale</b>				
U.S. Government Agencies				
Mortgage-Backed	\$263,059,074	\$ -	\$263,059,074	\$ -
State, County and Municipal	4,004,010	-	2,998,199	1,005,811
Corporate Obligations	1,104,900	-	1,104,900	-
Asset-Backed Securities	132,427	-	-	132,427
	<u>\$268,300,411</u>	<u>\$ -</u>	<u>\$267,162,173</u>	<u>\$ 1,138,238</u>
<b>Nonrecurring</b>				
Impaired Loans	<u>\$ 22,006,150</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$22,006,150</u>
Other Real Estate	<u>\$ 8,817,204</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,817,204</u>

#### Liabilities

The Company did not identify any liabilities that are required to be presented at fair value.

## (20) Fair Value of Financial Instruments and Fair Value Measurements (Continued)

### Fair Value Measurements (Continued)

#### *Fair Value Measurements Using Significant Unobservable Inputs (Level 3)*

The following tables present quantitative information about the significant unobservable inputs used in the fair value measurements for assets in level 3 of the fair value hierarchy measured on a nonrecurring basis at December 31, 2013 and 2012. These tables are comprised primarily of collateral dependent impaired loans and other real estate owned:

	<b>December 31, 2013</b>	<b>Valuation Techniques</b>	<b>Unobservable Inputs</b>	<b>Range (Weighted Avg)</b>
<b>Impaired Loans</b>				
Commercial	\$ 1,019,084	Sales Comparison	Adjustment for Differences Between the Comparable Sales	0.00%-15.00% (7.50%)
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	10.00%-50.00% (30.00%)
<b>Real Estate</b>				
Commercial Construction	2,641,041	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(16.00)%-28.00% (6.00%)
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00%-10.00% (5.00%)
		Income Approach	Capitalization Rate	8.50%
Residential Real Estate	1,323,296	Sales Comparison	Adjustment for Differences Between the Comparable Sales	0.00%-46.00% (23.00%)
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00%-25.00% (12.50%)
Commercial Real Estate	5,450,788	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(27.20%)-216.80% (94.80%)
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	25.00%-90.00% (57.50%)
		Income Approach	Capitalization Rate	11.00%
Farmland	1,241,482	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(55.00%)-388.00% (166.50)
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	10.00%-35.00% (22.50%)
Other Real Estate Owned	7,019,799	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(10.00%)-319.10% (154.55%)
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.36%-87.81% (29.99%)
		Income Approach	Discount Rate	10.00%

**(20) Fair Value of Financial Instruments and Fair Value Measurements (Continued)****Fair Value Measurements (Continued)**

	<b>December 31, 2012</b>	<b>Valuation Techniques</b>	<b>Unobservable Inputs</b>	<b>Range (Weighted Avg)</b>
<b>Impaired Loans</b>				
Commercial	\$ 1,030,877	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(45.00%)-80.00% (17.50%)
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00%-80.00% (40.00%)
		Income Approach	Capitalization Rate	8.50%
<b>Real Estate</b>				
Commercial Construction	5,885,060	Sales Comparison	Adjustment for Differences Between the Comparable Sales	0.00%-45.00% (22.50%)
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00%-40.00% (20.00%)
		Income Approach	Discount Rate	7.94%
Residential Real Estate	3,581,317	Sales Comparison	Adjustment for Differences Between the Comparable Sales	0.00%-24.00% (12.00%)
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00%-40.00% (20.00%)
		Income Approach	Capitalization Rate	8.90%
Commercial Real Estate	11,508,896	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(7.40%)-73.70% (32.95%)
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00%-40.00% (20.00%)
		Income Approach	Capitalization Rate	9.50%
			Discount Rate	5.13%
Other Real Estate Owned	8,817,204	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(35.00%)-129.50% (47.25%)
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	3.10%-61.32% (32.33%)
		Income Approach	Discount Rate	3.00%

## (20) Fair Value of Financial Instruments and Fair Value Measurements (Continued)

### Fair Value Measurements (Continued)

#### *Fair Value Measurements Using Significant Unobservable Inputs (Level 3) (Continued)*

The following table presents a reconciliation and statement of income classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (level 3) for the years ended December 31, 2013, 2012 and 2011.

	<b>Available for Sale Securities</b>		
	<b>2013</b>	2012	2011
<b>Balance, Beginning</b>	<b>\$ 1,138,238</b>	\$ 1,122,427	\$ 1,016,997
Transfers into Level 3	-	788,933	-
Transfers out of Level 3	<b>(41,908)</b>	-	-
Securities Purchased During the Year	-	-	-
Securities Called During the Year	-	(1,000,000)	-
Loss on OTTI Impairment Included in Noninterest Income	<b>(366,623)</b>	(59,568)	(53,058)
Unrealized Gains Included in Other Comprehensive Income	<b>211,558</b>	78,201	158,488
<b>Balance, Ending</b>	<b>\$ 941,265</b>	<b>\$ 1,138,238</b>	<b>\$ 1,122,427</b>

The Company's policy is to recognize transfers in and transfers out of levels 1, 2 and 3 as of the end of a reporting period. During the year ended December 31, 2013, the Company had transfers out of level 3 and into level 2. The transfers out of level 3 were the result of increased market activity for these types of securities, as well as more current credit ratings on these securities. During the year ended December 31, 2012, the Company transferred certain state, county and municipal securities out of level 2 and into level 3. The transfers into level 3 were the result of decreased market activity for these types of securities, as well as a lack of current credit ratings on these securities. There were no gains or losses recognized as a result of the transfers. There were no transfers of securities between level 1 and level 2 for the years ended December 31, 2013, 2012 or 2011.

The following table presents quantitative information about recurring level 3 fair value measurements as of December 31, 2013.

	<b>Fair Value</b>	<b>Valuation Techniques</b>	<b>Unobservable Inputs</b>	<b>Range (Weighted Avg)</b>
State, County and Municipal	<b>\$ 941,265</b>	Discounted Cash Flow	Discount Rate or Yield	N/A*

\* The Company relies on a third-party pricing service to value its municipal securities. The details of the unobservable inputs and other adjustments used by the third-party pricing service were not readily available to the Company.



## **(21) Regulatory Capital Matters**

The amount of dividends payable to the parent company from the subsidiary bank is limited by various banking regulatory agencies. Upon approval by regulatory authorities, the Bank may pay cash dividends to the parent company in excess of regulatory limitations. Additionally, the Company suspended the payment of dividends to its stockholders in the third quarter of 2009. At December 31, 2013, the Company is subject to certain regulatory restrictions that preclude the declaration of or payment of any dividends to its common stockholders, without prior approval from the Federal Reserve Bank.

The Company is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and, possibly, additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets. The amounts and ratios as defined in regulations are presented hereafter. Management believes, as of December 31, 2013, the Company meets all capital adequacy requirements to which it is subject under the regulatory framework for prompt corrective action. In the opinion of management, there are no conditions or events since prior notification of capital adequacy from the regulators that have changed the institution's category.

## (21) Regulatory Capital Matters (Continued)

The following table summarizes regulatory capital information as of December 31, 2013 and 2012 on a consolidated basis and for its wholly-owned subsidiary, as defined.

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<b>As of December 31, 2013</b>			(In Thousands)			
Total Capital to Risk-Weighted Assets						
Consolidated	\$129,569	17.06%	\$60,791	8.00%	N/A	N/A
Colony Bank	131,024	17.29	60,638	8.00	\$75,797	10.00%
Tier I Capital to Risk-Weighted Assets						
Consolidated	120,048	15.81	30,396	4.00	N/A	N/A
Colony Bank	121,521	16.03	30,319	4.00	45,478	6.00
Tier I Capital to Average Assets						
Consolidated	120,048	10.57	45,419	4.00	N/A	N/A
Colony Bank	121,521	10.72	45,333	4.00	56,666	5.00
<b>As of December 31, 2012</b>						
Total Capital to Risk-Weighted Assets						
Consolidated	\$122,630	16.47%	\$59,548	8.00%	N/A	N/A
Colony Bank	123,463	16.61	59,474	8.00	\$74,342	10.00%
Tier I Capital to Risk-Weighted Assets						
Consolidated	113,283	15.22	29,774	4.00	N/A	N/A
Colony Bank	114,128	15.35	29,737	4.00	44,605	6.00
Tier I Capital to Average Assets						
Consolidated	113,283	10.22	44,343	4.00	N/A	N/A
Colony Bank	114,128	10.31	44,282	4.00	55,352	5.00

Effective October 1, 2013, the Memorandum of Understanding (MOU) the Bank had been operating under was lifted; however, the Bank remains subject to a Board Resolution (BR) which requires, among other things, that the Bank maintain minimum capital ratios at specified levels higher than those otherwise required by applicable regulations as follows: Tier 1 capital to total average assets of 8 percent and total risk-based capital to total risk-weighted assets of 10 percent during the life of the BR. The BR also requires that, prior to declaring or paying any cash dividend to the Company, the Bank must obtain written consent of its regulators. Additional requirements of the BR are discussed in Part 1, Item 1 of the Company's December 31, 2013 Form 10-K filed with the Securities Exchange Commission on March 14, 2014. Failure to comply with the terms of the BR could have an adverse impact on the Company's consolidated financial condition.

**(22) Financial Information of Colony Bankcorp, Inc. (Parent Only)**

The parent company's balance sheets as of December 31, 2013 and 2012 and the related statements of operations and comprehensive income (loss) and cash flows for each of the years in the three-year period then ended are as follows:

**COLONY BANKCORP, INC. (PARENT ONLY)**  
**BALANCE SHEETS**  
**DECEMBER 31**

**ASSETS**

	<u>2013</u>	<u>2012</u>
Cash	\$ 1,422,289	\$ 494,432
Premises and Equipment, Net	1,272,965	1,284,968
Investment in Subsidiary, at Equity	114,559,866	119,646,209
Other	1,221,285	821,145
<b>Total Assets</b>	<b><u>\$118,476,405</u></b>	<b><u>\$122,246,754</u></b>

**LIABILITIES AND STOCKHOLDERS' EQUITY**

<b>Liabilities</b>		
Dividends Payable	\$ 3,119,146	\$ 1,610,385
Other	1,174,020	648,202
	<u>4,293,166</u>	<u>2,258,587</u>
<b>Subordinated Debt</b>	<b><u>24,229,000</u></b>	<b><u>24,229,000</u></b>
<b>Stockholders' Equity</b>		
Preferred Stock, Stated Value \$1,000; Authorized 10,000,000 Shares, Issued 28,000 Shares	28,000,000	27,827,053
Common Stock, Par Value \$1; Authorized 20,000,000 Shares, Issued 8,439,258 Shares as of December 31, 2013 and 2012	8,439,258	8,439,258
Paid-In Capital	29,145,094	29,145,094
Retained Earnings	33,444,913	30,497,576
Accumulated Other Comprehensive Loss, Net of Tax	(9,075,026)	(149,814)
	<u>89,954,239</u>	<u>95,759,167</u>
<b>Total Liabilities and Stockholders' Equity</b>	<b><u>\$118,476,405</u></b>	<b><u>\$122,246,754</u></b>

(22) Financial Information of Colony Bankcorp, Inc. (Parent Only) (Continued)

**COLONY BANKCORP, INC. (PARENT ONLY)**  
**STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 31**

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>Income</b>			
Dividends from Subsidiary	\$ 1,515,549	\$ 17,372	\$ 15,265
Management Fees	581,334	590,422	505,414
Other	96,953	101,397	98,180
	<u>2,193,836</u>	<u>709,191</u>	<u>618,859</u>
<b>Expenses</b>			
Interest	516,641	554,004	508,081
Amortization	2,250	2,250	2,250
Salaries and Employee Benefits	748,149	735,919	734,104
Other	543,139	558,151	656,914
	<u>1,810,179</u>	<u>1,850,324</u>	<u>1,901,349</u>
<b>Income (Loss) Before Taxes and Equity in Undistributed Earnings of Subsidiary</b>	<b>383,657</b>	<b>(1,141,133)</b>	<b>(1,282,490)</b>
Income Tax Benefits	406,518	365,691	425,605
<b>Income (Loss) Before Equity in Undistributed Earnings of Subsidiary</b>	<b>790,175</b>	<b>(775,442)</b>	<b>(856,885)</b>
Equity in Undistributed Earnings of Subsidiary	3,838,870	3,416,740	3,390,480
<b>Net Income</b>	<b>4,629,045</b>	<b>2,641,298</b>	<b>2,533,595</b>
Preferred Stock Dividends	1,508,761	1,435,385	1,400,000
<b>Net Income Available to Common Stockholders</b>	<b><u><u>\$ 3,120,284</u></u></b>	<b><u><u>\$ 1,205,913</u></u></b>	<b><u><u>\$ 1,133,595</u></u></b>

**(22) Financial Information of Colony Bankcorp, Inc. (Parent Only) (Continued)**

**COLONY BANKCORP, INC. (PARENT ONLY)  
STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
FOR THE YEARS ENDED DECEMBER 31**

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>Net Income</b>	<b><u>\$4,629,045</u></b>	<b><u>\$ 2,641,298</u></b>	<b><u>\$ 2,533,595</u></b>
<b>Other Comprehensive Income (Loss), Net of Tax</b>			
Gains (Losses) on Securities Arising During the Year, Net of Tax Effect of \$(4,597,836), \$(1,060,984) and \$1,292,789, Respectively	<b>(9,165,323)</b>	(186,830)	4,439,108
Impairment Loss on Securities, Net of Tax Effect of \$(124,652), \$(20,253) and \$(18,040), Respectively	<b>241,971</b>	39,315	35,018
Realized Gains (Losses) on Sale of AFS Securities, Net of Tax Effect of \$959, \$984,991 and \$1,012,064, Respectively	<b><u>(1,860)</u></b>	<b><u>(1,912,041)</u></b>	<b><u>(1,964,595)</u></b>
Change in Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects	<b><u>(8,925,212)</u></b>	<b><u>(2,059,556)</u></b>	<b><u>2,509,531</u></b>
<b>Comprehensive Income (Loss)</b>	<b><u><u>\$ (4,296,167)</u></u></b>	<b><u><u>\$ 581,742</u></u></b>	<b><u><u>\$ 5,043,126</u></u></b>

(22) Financial Information of Colony Bankcorp, Inc. (Parent Only) (Continued)

**COLONY BANKCORP, INC. (PARENT ONLY)**  
**STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31**

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>Cash Flows from Operating Activities</b>			
Net Income	<b>\$ 4,629,045</b>	\$ 2,641,298	\$ 2,533,595
Adjustments to Reconcile Net Income to Net Cash Provided (Used) by Operating Activities			
Depreciation and Amortization	<b>80,711</b>	93,427	112,651
Equity in Undistributed Earnings of Subsidiary	<b>(3,838,870)</b>	(3,416,740)	(3,390,480)
Other	<b>125,679</b>	124,543	24,977
	<u><b>996,565</b></u>	<u>(557,472)</u>	<u>(719,257)</u>
<b>Cash Flows from Investing Activities</b>			
Purchases of Premises and Equipment	<u><b>(68,708)</b></u>	<u>-</u>	<u>(1,900)</u>
<b>Cash Flows from Financing Activities</b>			
Dividends Paid on Preferred Stock	<u>-</u>	<u>-</u>	<u>(1,400,000)</u>
<b>Increase (Decrease) in Cash</b>	<b>927,857</b>	(557,472)	(2,121,157)
<b>Cash, Beginning</b>	<u><b>494,432</b></u>	<u>1,051,904</u>	<u>3,173,061</u>
<b>Cash, Ending</b>	<u><b>\$ 1,422,289</b></u>	<u>\$ 494,432</u>	<u>\$ 1,051,904</u>

## (23) Earnings Per Share

Basic earnings per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during each period. Diluted earnings per share reflects the potential dilution of restricted stock and common stock warrants. Net income available to common stockholders represents net income (loss) after preferred stock dividends. The following table presents earnings per share for the years ended December 31, 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>Numerator</b>			
Net Income (Loss) Available to Common Stockholders	<u>\$ 3,120,284</u>	<u>\$ 1,205,913</u>	<u>\$ 1,133,595</u>
<b>Denominator</b>			
Weighted Average Number of Common Shares Outstanding for Basic Earnings Per Common Share	<u>8,439,258</u>	<u>8,439,258</u>	<u>8,439,258</u>
Dilutive Effect of Potential Common Stock			
Restricted Stock	-	-	-
Stock Warrants	-	-	-
Weighted-Average Number of Shares Outstanding for Diluted Earnings Per Common Share	<u>8,439,258</u>	<u>8,439,258</u>	<u>8,439,258</u>
Earnings (Loss) Per Share - Basic	<u>\$ 0.37</u>	<u>\$ 0.14</u>	<u>\$ 0.13</u>
Earnings (Loss) Per Share - Diluted	<u>\$ 0.37</u>	<u>\$ 0.14</u>	<u>\$ 0.13</u>

For the years ended December 31, 2013, 2012 and 2011, respectively, the Company has excluded 500,000, 500,000 and 501,855 common stock equivalents with strike prices that would cause them to be antidilutive.

## **Management’s Discussion and Analysis of Financial Condition and Results of Operations**

### **Forward-Looking Statements and Factors that Could Affect Future Results**

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

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

- Local and regional economic conditions and the impact they may have on the Company and its customers and the Company’s assessment of that impact.
- Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.
- The effects of and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve Board.
- Inflation, interest rate, market and monetary fluctuations.
- Political instability.
- Acts of war or terrorism.
- The timely development and acceptance of new products and services and perceived overall value of these products and services by users.
- Changes in consumer spending, borrowings and savings habits.
- Technological changes.
- Acquisitions and integration of acquired businesses.
- The ability to increase market share and control expenses.



- The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Company and its subsidiaries must comply.
- The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters.
- Changes in the Company's organization, compensation and benefit plans.
- The costs and effects of litigation and of unexpected or adverse outcomes in such litigation.
- Greater than expected costs or difficulties related to the integration of new lines of business.
- The Company's success at managing the risks involved in the foregoing items.
- Restrictions or conditions imposed by our regulators on our operations, including the terms of our Board Resolution.

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

## **The Company**

Colony Bankcorp, Inc. (Colony) is a bank holding company headquartered in Fitzgerald, Georgia that provides, through its wholly-owned subsidiary (collectively referred to as the Company), a broad array of products and services throughout central, south and coastal Georgia markets. The Company offers commercial, consumer and mortgage banking services.

## **Application of Critical Accounting Policies and Accounting Estimates**

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. The Company's financial position and results of operations are affected by management's application of accounting policies, including judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company's financial position and/or results of operations. Critical accounting policies are those policies that management believes are the most important to the portrayal of the Company's financial condition and results of operations, and they require management to make estimates that are difficult and subjective or complete.

**Allowance for Loan Losses** - The allowance for loan losses provides coverage for probable losses inherent in the Company's loan portfolio. Management evaluates the adequacy of the allowance for loan losses quarterly based on changes, if any, in underwriting activities, the loan portfolio composition (including product mix and geographic, industry or customer-specific concentrations), trends in loan performance, regulatory guidance and economic factors. This evaluation is inherently subjective, as it requires the use of significant management estimates. Many factors can affect management's estimates of specific and expected losses, including volatility of default probabilities, collateral values, rating migrations, loss severity and economic and political conditions. The allowance is increased through provisions charged to operating earnings and reduced by net charge-offs.

The Company determines the amount of the allowance based on relative risk characteristics of the loan portfolio. The allowance recorded for loans is based on reviews of individual credit relationships and historical loss experience. The allowance for losses relating to impaired loans is based on the loan's observable market price, the discounted cash flows using the loan's effective interest rate, or the value of collateral for collateral dependent loans.

Regardless of the extent of the Company's analysis of customer performance, portfolio trends or risk management processes, certain inherent but undetected losses are probable within the loan portfolio. This is due to several factors, including inherent delays in obtaining information regarding a customer's financial condition or changes in their unique business conditions, the judgmental nature of individual loan evaluations, collateral assessments and the interpretation of economic trends. Volatility of economic or customer-specific conditions affecting the identification and estimation of losses for larger nonhomogeneous credits and the sensitivity of assumptions utilized to establish allowances for homogeneous groups of loans are among other factors. The Company estimates a range of inherent losses related to the existence of these exposures. The estimates are based upon the Company's evaluation of risk associated with the commercial and consumer levels and the estimated impact of the current economic environment.

### **Other Real Estate Owned and Foreclosed Assets**

Other real estate owned (OREO) or other foreclosed assets acquired through loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. The adjustment at the time of foreclosure is recorded through the allowance for loan losses. Due to the subjective nature of establishing the fair value when the asset is acquired, the actual fair value of the other real estate owned or foreclosed asset could differ from the original estimate. If it is determined that fair value declines subsequent to foreclosure, the valuation allowance is adjusted through a charge to noninterest expense. Operating costs associated with the assets after acquisition are also recorded as noninterest expense. Gains and losses on the disposition of other real estate owned and foreclosed assets are netted and recognized in noninterest expense. Management obtains appraisals performed by certified, third-parties within one year of placing a property into OREO. The fair value of the property is then evaluated by management annually going forward, or more often if necessary. Annual evaluations may be performed by certified third parties, or internally by management comparing recent sales of similar properties within the Company's OREO portfolio.

### **Overview**

The following discussion and analysis presents the more significant factors affecting the Company's financial condition as of December 31, 2013 and 2012, and results of operations for each of the years in the three-year period ended December 31, 2013. This discussion and analysis should be read in conjunction with the Company's consolidated financial statements, notes thereto and other financial information appearing elsewhere in this report.

Taxable-equivalent adjustments are the result of increasing income from tax-free loans and investments by an amount equal to the taxes that would be paid if the income were fully taxable based on a 34 percent federal tax rate, thus making tax-exempt yields comparable to taxable asset yields.

Dollar amounts in tables are stated in thousands, except for per share amounts.

## Results of Operations

The Company's results of operations are determined by its ability to effectively manage interest income and expense, to minimize loan and investment losses, to generate noninterest income and to control noninterest expense. Since market forces and economic conditions beyond the control of the Company determine interest rates, the ability to generate net interest income is dependent upon the Company's ability to obtain an adequate spread between the rate earned on earning assets and the rate paid on interest-bearing liabilities. Thus, the key performance for net interest income is the interest margin or net yield, which is taxable-equivalent net interest income divided by average earning assets. Net income (loss) available to common shareholders totaled \$3.12 million, or \$0.37 per diluted common share in 2013, compared to \$1.21 million, or \$0.14 per diluted common share in 2012, compared to \$1.13 million, or \$0.13 per diluted common share in 2011.

Selected income statement data, returns on average assets and average equity and dividends per share for the comparable periods were as follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Taxable-Equivalent Net Interest Income	\$ 37,859	\$ 36,417	\$ 35,178
Taxable-Equivalent Adjustment	<u>170</u>	<u>144</u>	<u>191</u>
Net Interest Income	<b>37,689</b>	36,273	34,987
Provision for Loan Losses	<b>4,485</b>	6,785	8,250
Noninterest Income	<b>8,377</b>	9,733	9,951
Noninterest Expense	<u><b>34,617</b></u>	<u>35,379</u>	<u>33,051</u>
Income Before Income Taxes	<b>6,964</b>	3,842	3,637
Income Taxes	<u><b>2,335</b></u>	<u>1,201</u>	<u>1,104</u>
Net Income	<u><b>\$ 4,629</b></u>	<u>\$ 2,641</u>	<u>\$ 2,533</u>
Preferred Stock Dividends	<u><b>1,509</b></u>	<u>1,435</u>	<u>1,400</u>
Net Income Available to Common Stockholders	<u><b>\$ 3,120</b></u>	<u>\$ 1,206</u>	<u>\$ 1,133</u>
Basic per Common Share:			
Net Income	\$ <b>0.37</b>	\$ 0.14	\$ 0.13
Diluted per Common Share:			
Net Income	\$ <b>0.37</b>	\$ 0.14	\$ 0.13
Return on Average Assets (1)	<b>0.28%</b>	0.11%	0.09%
Return on Average Equity (1)	<b>3.34%</b>	1.25%	1.20%

(1) Computed using net income available to common shareholders.

Net income available to common shareholders for 2013 increased \$1.91 million, or 158.71 percent, compared to 2012. The increase was primarily the result of an increase of \$1.42 million in net interest income, a decrease of \$2.3 million in provision for loan losses and a decrease of \$762 thousand in noninterest expense. The impact of these items was partly offset by a decrease of \$1.36 million in noninterest income and an increase of \$1.13 million in income tax expense.

Net income available to common shareholders for 2012 increased \$73 thousand, or 6.44 percent, compared to 2011. The increase was primarily the result of a \$1.47 million decrease in provision for loan losses and an increase of \$1.29 million in net interest income. The impact of these items was partly offset by a \$218 thousand decrease in noninterest income, an increase of \$2.33 million in noninterest expense and an increase of \$97 thousand in income tax expense.

Details of the changes in the various components of net income are further discussed below.

### **Net Interest Income**

Net interest income is the difference between interest income on earning assets, such as loans and securities, and interest expense on liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest income is the Company's largest source of revenue, representing 81.82 percent of total revenue during 2013 and 78.84 percent during 2012.

Net interest margin is the taxable-equivalent net interest income as a percentage of average earning assets for the period. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and net interest margin.

The Federal Reserve Board influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The Company's loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit is currently 3.25 percent and has been for the past four years. The federal funds rate moved similar to prime rate with interest rates currently at 0.25 percent and has been for the past four years. We anticipate the Federal Reserve maintaining its current interest rate policy in 2014, which should result in Colony's net interest margin remaining stable.

The following table presents the changes in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of earning assets and interest-bearing liabilities and the changes due to changes in the average interest rate on those assets and liabilities. The changes in net interest income due to changes in both average volume and average interest rate have been allocated to the average volume change or the average interest rate change in proportion to the absolute amounts of the change in each. The Company's consolidated average balance sheets along with an analysis of taxable-equivalent net interest earnings are presented in the Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.

## Rate/Volume Analysis

The rate/volume analysis presented hereafter illustrates the change from year to year for each component of the taxable equivalent net interest income separated into the amount generated through volume changes and the amount generated by changes in the yields/rates.

	Changes From 2012 to 2013 (a)			Changes From 2011 to 2012 (a)		
	Volume	Rate	Total	Volume	Rate	Total
Interest Income						
Loans, Net-Taxable	\$ 1,327	\$ (1,908)	\$ (581)	\$ (2,406)	\$ (133)	\$ (2,539)
Investment Securities						
Taxable	(145)	(1,263)	(1,408)	(377)	(1,630)	(2,007)
Tax-Exempt	(20)	4	(16)	(2)	(14)	(16)
Total Investment Securities	(165)	(1,259)	(1,424)	(379)	(1,644)	(2,023)
Interest-Bearing Deposits in						
Other Banks	(33)	37	4	(4)	34	30
Federal Funds Sold	(60)	-	(60)	(15)	(1)	(16)
Other Interest - Earning Assets	(10)	(6)	(16)	(12)	9	(3)
Total Interest Income	1,059	(3,136)	(2,077)	(2,816)	(1,735)	(4,551)
Interest Expense						
Interest-Bearing Demand and Savings Deposits	141	(64)	77	253	(227)	26
Time Deposits	(892)	(2,101)	(2,993)	(1,762)	(2,477)	(4,239)
Total Interest Expense On Deposits	(751)	(2,165)	(2,916)	(1,509)	(2,704)	(4,213)
Other Interest-Bearing Liabilities						
Federal Funds Purchased and Repurchase Agreements	(136)	(430)	(566)	(338)	-	(338)
Subordinated Debentures	-	(37)	(37)	-	46	46
Other Debt	-	-	-	(1,175)	(110)	(1,285)
Total Interest Expense	(887)	(2,632)	(3,519)	(3,022)	(2,768)	(5,790)
Net Interest Income (Loss)	\$ 1,946	\$ (504)	\$ 1,442	\$ 206	\$ 1,033	\$ 1,239

- (a) Changes in net interest income for the periods, based on either changes in average balances or changes in average rates for interest-earning assets and interest-bearing liabilities, are shown on this table. During each year there are numerous and simultaneous balance and rate changes; therefore, it is not possible to precisely allocate the changes between balances and rates. For the purpose of this table, changes that are not exclusively due to balance changes or rate changes have been attributed to rates.

Our financial performance is impacted by, among other factors, interest rate risk and credit risk. We do not utilize derivatives to mitigate our credit risk, relying instead on an extensive loan review process and our allowance for loan losses.

Interest rate risk is the change in value due to changes in interest rates. The Company is exposed only to U.S. dollar interest rate changes and, accordingly, the Company manages exposure by considering the possible changes in the net interest margin. The Company does not have any trading instruments nor does it classify any portion of its investment portfolio as held for trading. The Company does not engage in any hedging activity or utilize any derivatives. The Company has no exposure to foreign currency exchange rate risk, commodity price risk and other market risks. Interest rate risk is addressed by our Asset & Liability Management Committee (ALCO) which includes senior management representatives. The ALCO monitors interest rate risk by analyzing the potential impact to the net portfolio of equity value and net interest income from potential changes to interest rates and considers the impact of alternative strategies or changes in balance sheet structure.

Interest rates play a major part in the net interest income of financial institutions. The repricing of interest earnings assets and interest-bearing liabilities can influence the changes in net interest income. The timing of repriced assets and liabilities is Gap management and our Company has established its policy to maintain a Gap ratio in the one-year time horizon of .80 to 1.20.

Our exposure to interest rate risk is reviewed at least quarterly by our Board of Directors and the ALCO. Interest rate risk exposure is measured using interest rate sensitivity analysis to determine our change in net portfolio value in the event of assumed changes in interest rates. In order to reduce the exposure to interest rate fluctuations, we have implemented strategies to more closely match our balance sheet composition. The Company has engaged FTN Financial to run a quarterly asset/liability model for interest rate risk analysis. We are generally focusing our investment activities on securities with terms or average lives in the 2-5 year range.

The Company maintains about 14.7 percent of its loan portfolio in adjustable rate loans that reprice with prime rate changes, while the bulk of its other loans mature within 3 years. The liabilities to fund assets are primarily in short term certificates of deposit that mature within one year. This balance sheet composition allowed the Company to be relatively constant with its net interest margin until 2008. During 2007, interest rates decreased 100 basis points and this decrease by the Federal Reserve in 2007 followed by 400 basis point decrease in 2008 resulted in significant pressure in net interest margins. While the Federal Reserve rates have remained unchanged since 2008, we have seen the net interest margin increase to 3.61 percent for 2013, compared to 3.41 percent for 2012 and to 3.11 percent for 2011. Given the Federal Reserve's aggressive posture during 2008 that ended the year with a range of 0 - 0.25 percent federal funds target rate and remained the same for all of 2013, we have seen our net interest margin reach a low of 3.45 percent for first quarter 2013 to a high of 3.68 percent for fourth quarter 2013.

Taxable-equivalent net interest income for 2013 increased by \$1.44 million, or 3.96 percent, compared to 2012 while taxable-equivalent net interest income for 2012 increased by \$1.24 million, or 3.52 percent, compared to 2011. The average volume of earning assets during 2013 decreased \$18.15 million compared to 2012 while over the same period the net interest margin increased to 3.61 from 3.41 percent. Improvement in the net interest margin in 2013 was primarily driven by reduction in the cost of funds and maintaining longer term investments. Similarly, the average volume of earning assets during 2012 decreased \$66.19 million compared to 2011 while over the same period the net interest margin increased to 3.41 from 3.11 percent. The decline in average earning assets in 2013 affected each category of assets except loans, while the significant decrease was primarily in average investment securities. Reduction in average earning assets during 2012 and 2011 was primarily in loans and investment securities, even though each category declined. The increase in the net interest margin in 2012 was primarily the result of the reduction in the cost of funds and maintaining longer term investments.

The average volume of loans increased \$22.76 million in 2013 compared to 2012, and decreased \$41.20 million in 2012 compared to 2011. The average yield on loans decreased 26 basis points in 2013 compared to 2012 and decreased 1 basis point in 2012 compared to 2011. The average volume of deposits decreased \$16.38 million while other borrowings decreased \$3.41 million in 2013 compared to 2012. The average volume of other borrowings decreased \$37.83 million in 2012 compared to 2011 while average deposits decreased \$31.03 million in 2012 compared to 2011. Interest-bearing deposits made up 165.77 percent of the decrease in average deposits in 2013 and 125.76 percent of the decrease in average deposits in 2012. Accordingly, the ratio of average interest-bearing deposits to total average deposits was 88.2 percent in 2013, 89.5 percent in 2012 and 90.6 percent in 2011. This deposit mix, combined with a general decrease in interest rates, had the effect of (i) decreasing the average cost of total deposits by 29 basis points in 2013 compared to 2012 and decreasing the average cost of total deposits by 39 basis points in 2012 compared to 2011, and (ii) mitigating a portion of the impact of decreasing yields on earning assets on the Company's net interest income.

The Company's net interest spread, which represents the difference between the average rate earned on earning assets and the average rate paid on interest-bearing liabilities, was 3.50 percent in 2013 compared to 3.27 percent in 2012 and 2.93 percent in 2011. The net interest spread, as well as the net interest margin, will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment. A discussion of the effects of changing interest rates on net interest income is set forth in *Quantitative and Qualitative Disclosures About Interest Rate Sensitivity* included elsewhere in this report.

### **Provision for Loan Losses**

The provision for loan losses is determined by management as the amount to be added to the allowance for loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for loan losses totaled \$4.49 million in 2013 compared to \$6.79 million in 2012 and \$8.25 million in 2011. See the section captioned "Allowance for Loan Losses" elsewhere in this discussion for further analysis of the provision for loan losses.

## Noninterest Income

The components of noninterest income were as follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Service Charges on Deposit Accounts	\$ 4,691	\$ 3,573	\$ 3,244
Other Charges, Commissions and Fees	1,725	1,515	1,312
Other	1,206	1,102	1,259
Mortgage Fee Income	484	400	265
Securities Gains (Losses)	(364)	2,837	2,924
Gain on Sale of SBA Loans	635	306	947
	<u>\$ 8,377</u>	<u>\$ 9,733</u>	<u>\$ 9,951</u>

Total noninterest income for 2013 decreased \$1.36 million, or 13.93 percent, compared to 2012 while total noninterest income for 2012 decreased \$218 thousand, or 2.19 percent, compared to 2011. The decrease in 2013 noninterest income compared to 2012 was primarily in securities gains while the decrease in 2012 noninterest income compared to 2011 was primarily in gain on sale of SBA loans. Changes in these items and the other components of noninterest income are discussed in more detail below.

*Service Charges on Deposit Accounts.* Service charges on deposit accounts for 2013 increased \$1.12 million, or 31.29 percent, compared to 2012. Service charges on deposit accounts for 2012 increased \$329 thousand, or 10.14 percent, compared to 2011. The increase in 2013 was primarily due to an increase in volume of consumer and business account overdraft fees.

*Mortgage Fee Income.* Mortgage fee income for 2013 increased \$84 thousand, or 21.00 percent, compared to 2012 while mortgage fee income for 2012 increased \$135 thousand, or 50.94 percent, compared to 2011. The increase in 2013 and 2012 was due to increased mortgage loan activity due to an initiative to increase mortgage lending opportunities given the low interest rate environment.

*Security Gains.* The Company realized losses from the sale of securities of \$364 thousand for 2013, which included approximately \$360 thousand for other-than-temporary impairment (OTTI) on one investment, compared to gains of \$2.83 million for 2012 and \$2.92 million in 2011.

*All Other Noninterest Income.* Other charges, commissions and fees, other income and gain on sale of SBA loans for 2013 increased \$643 thousand, or 22.00 percent, compared to 2012. The increase was primarily attributable to the rise in the gain on sale of SBA loans. In 2012 other charges, commissions and fees, other income and gain on sale of SBA loans for 2012 decreased \$595 thousand, or 16.91 percent, compared to 2011. The decrease was primarily attributable to the decline in gain on sale of SBA loans for 2012 compared to 2011.



## Noninterest Expense

The components of noninterest expense were as follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Salaries and Employee Benefits	\$ 16,692	\$ 15,565	\$ 14,633
Occupancy and Equipment	3,795	3,878	3,998
Other	<u>14,130</u>	<u>15,936</u>	<u>14,420</u>
	<u>\$ 34,617</u>	<u>\$ 35,379</u>	<u>\$ 33,051</u>

Total noninterest expense for 2013 decreased \$762 thousand, or 2.15 percent compared to 2012 while total noninterest expense increased \$2.33 million, or 7.04 percent compared to 2011. Reduction in noninterest expense in 2013 was primarily in all other noninterest expense and occupancy and equipment while the Company had a slight increase in salaries and employee benefits. Growth in noninterest expense in 2012 was primarily in salaries and employee benefits and other noninterest expense while the Company had a slight decrease in occupancy and equipment.

*Salaries and Employee Benefits.* Salaries and employee benefits expense for 2013 increased \$1.13 million, or 7.24 percent, compared to 2012. This increase is primarily attributable to an increase in headcount related to increased regulatory compliance demands. Salaries and employee benefits expense for 2012 increased \$932 thousand, or 6.37 percent, compared to 2011.

*Occupancy and Equipment.* Occupancy expense for 2013 decreased \$83 thousand compared to 2012, or a decrease of 2.14 percent. Occupancy expense for 2012 decreased \$120 thousand compared to 2011, or a decrease of 3.00 percent. The decrease in occupancy expense in 2012 is primarily due to a reduction in depreciation expense of \$113 thousand from 2011.

*All Other Noninterest Expense.* All other noninterest expense for 2013 decreased \$1.81 million, or 11.33 percent. Significant changes in noninterest expense were: FDIC insurance assessment fees decreased to \$1.32 million for 2013 compared to \$1.50 million for 2012, or a decrease of \$176 thousand, legal and professional fees decreased to \$721 thousand for 2013 in comparison to \$1.1 million for 2012, or a decrease of \$365 thousand, foreclosed property and repossession expense decreased to \$3.9 million in 2013 compared to \$5.6 million in 2012, or a decrease of \$1.70 million, and advertising increased to \$508 thousand in 2013 compared to \$423 thousand in 2012, or an increase of \$86 thousand. All other noninterest expense for 2012 increased \$1.52 million, or 10.51 percent. Significant changes in noninterest expense were: FDIC insurance assessment fees decreased to \$1.50 million for 2012 compared to \$1.83 million for 2011, or a decrease of \$331 thousand; foreclosed property and repossession expense increased to \$5.6 million for 2012 compared to \$4.0 million for 2011, or an increase of \$1.57 million, legal and professional fees decreased to \$1.1 million for 2012 in comparison to \$1.2 million for 2011, or a decrease of \$101 thousand, and advertising decreased to \$423 thousand in 2012 compared to \$508 thousand, or 16.84 percent.

## Sources and Uses of Funds

The following table illustrates, during the years presented, the mix of the Company's funding sources and the assets in which those funds are invested as a percentage of the Company's average total assets for the period indicated. Average assets totaled \$1.12 billion in 2013 compared to \$1.14 billion in 2012 and \$1.21 billion in 2011.

	2013		2012		2011	
Sources of Funds:						
Deposits:						
Noninterest-Bearing	\$ 112,667	10.1%	\$ 101,896	8.9%	\$ 93,903	7.8%
Interest-Bearing	840,646	75.2%	867,794	76.1%	906,816	75.2%
Federal Funds Purchased and Repurchase Agreements	34	0.0%	-	- %	9,851	0.8%
Subordinated Debentures and Other Borrowed Money	64,528	5.8%	67,974	6.0%	95,949	8.0%
Other Noninterest-Bearing Liabilities	6,838	0.6%	5,609	0.5%	4,635	0.4%
Equity Capital	93,358	8.3%	96,541	8.5%	94,737	7.8%
Total	<u>\$ 1,118,071</u>	<u>100.0%</u>	<u>\$ 1,139,814</u>	<u>100.0%</u>	<u>\$ 1,205,891</u>	<u>100.0%</u>
Uses of Funds:						
Loans (Net of Allowance)	\$ 731,280	65.4%	\$ 706,091	62.0%	\$ 742,482	61.6%
Investment Securities	275,689	24.7%	284,261	24.9%	300,293	24.9%
Federal Funds Sold	14,969	1.3%	38,877	3.4%	44,667	3.7%
Interest-Bearing Deposits	9,625	0.9%	17,046	1.5%	18,715	1.5%
Other Interest-Earning Assets	3,275	0.3%	4,277	0.4%	5,781	0.5%
Other Noninterest-Earning Assets	83,233	7.4%	89,262	7.8%	93,953	7.8%
Total	<u>\$ 1,118,071</u>	<u>100.0%</u>	<u>\$ 1,139,814</u>	<u>100.0%</u>	<u>\$ 1,205,891</u>	<u>100.0%</u>

Deposits continue to be the Company's primary source of funding. Over the comparable periods, the relative mix of deposits continues to be high in interest-bearing deposits. Interest-bearing deposits totaled 88.2 percent of total average deposits in 2013 compared to 89.5 percent in 2012 and 90.62 percent in 2011.

The Company primarily invests funds in loans and securities. Loans continue to be the largest component of the Company's mix of invested assets. Loan demand increased in 2013 as total loans were \$751.2 million at December 31, 2013, up 0.6 percent, compared to loans of \$747.1 million at December 31, 2012, while total loans at December 31, 2012 were up 4.3 percent, compared to loans of \$716.3 million at December 31, 2011. See additional discussion regarding the Company's loan portfolio in the section captioned "Loans" included below. The majority of funds provided by deposits have been invested in loans.

## Loans

The following table presents the composition of the Company's loan portfolio as of December 31 for the past five years.

	<u>2013</u>	2012	2011	2010	2009
Commercial, Financial and Agricultural	\$ 58,773	\$ 61,895	\$ 57,408	\$ 63,772	\$ 80,984
Real Estate					
Construction	59,288	59,660	62,076	76,682	113,117
Mortgage, Farmland	47,034	49,057	48,225	52,778	54,965
Mortgage, Other	548,041	538,231	508,919	570,350	626,993
Consumer	25,676	29,778	30,449	33,564	38,383
Other	12,406	8,429	9,244	16,104	16,950
	<u>751,218</u>	<u>747,050</u>	<u>716,321</u>	<u>813,250</u>	<u>931,392</u>
Unearned Interest and Fees	(360)	(234)	(57)	(61)	(140)
Allowance for Loan Losses	<u>(11,806)</u>	<u>(12,737)</u>	<u>(15,650)</u>	<u>(28,280)</u>	<u>(31,401)</u>
Loans	<u>\$ 739,052</u>	<u>\$ 734,079</u>	<u>\$ 700,614</u>	<u>\$ 784,909</u>	<u>\$ 899,851</u>

The following table presents total loans as of December 31, 2013 according to maturity distribution and/or repricing opportunity on adjustable rate loans.

### Maturity and Repricing Opportunity

One Year or Less	\$ 320,603
After One Year through Three Years	292,003
After Three Years through Five Years	71,745
Over Five Years	<u>66,867</u>
	<u>\$ 751,218</u>

*Overview.* Loans totaled \$751.2 million at December 31, 2013, up 0.6 percent from December 31, 2012 loans of \$747.1 million. The majority of the Company's loan portfolio is comprised of the real estate loans-mortgage other, real estate construction and commercial financial and agricultural loans. Real estate-other, which is primarily 1-4 family residential properties and nonfarm nonresidential properties, made up 72.95 percent and 72.05 percent of total loans, real estate construction made up 7.89 percent and 7.99 percent while commercial financial and agricultural loans made up 7.82 percent and 8.29 percent of total loans at December 31, 2013 and December 31, 2012, respectively. Real estate loans-mortgage other include both commercial and consumer balances.

*Loan Origination/Risk Management.* In accordance with the Company's decentralized banking model, loan decisions are made at the local bank level. The Company utilizes an Executive Loan Committee to assist lenders with the decision making and underwriting process of larger loan requests. Due to the diverse economic markets served by the Company, evaluation and underwriting criterion may vary slightly by market. Overall, loans are extended after a review of the borrower's repayment ability, collateral adequacy, and overall credit worthiness.

Commercial purpose, commercial real estate, and industrial loans are underwritten similar to other loans throughout the Company. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography, and risk grade criteria. The Company also utilizes information provided by third-party agencies to provide additional insight and guidance about economic conditions and trends affecting the markets it serves.

The Company extends loans to builders and developers that are secured by non-owner occupied properties. In such cases, the Company reviews the overall economic conditions and trends for each market to determine the desirability of loans to be extended for residential construction and development. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim mini-perm loan commitment from the Company until permanent financing is obtained. In some cases, loans are extended for residential loan construction for speculative purposes and are based on the perceived present and future demand for housing in a particular market served by the Company. These loans are monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, general economic conditions and trends, the demand for the properties, and the availability of long-term financing.

The Company originates consumer loans at the bank level. Due to the diverse economic markets served by the Company, underwriting criterion may vary slightly by market. The Company is committed to serving the borrowing needs of all markets served and, in some cases, adjusts certain evaluation methods to meet the overall credit demographics of each market. Consumer loans represent relatively small loan amounts that are spread across many individual borrowers to help minimize risk. Additionally, consumer trends and outlook reports are reviewed by management on a regular basis.

The Company utilizes an independent third party company for loan review and validation of the credit risk program on an ongoing quarterly basis. Results of these reviews are presented to management and the audit committee. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

*Commercial, Financial and Agricultural.* Commercial, financial and agricultural loans at December 31, 2013 decreased 5.0 percent from December 31, 2012 to \$58.8 million. The Company's commercial and industrial loans are a diverse group of loans to small, medium and large businesses. The purpose of these loans varies from supporting seasonal working capital needs to term financing of equipment. While some short-term loans may be made on an unsecured basis, most are secured by the assets being financed with collateral margins that are consistent with the Company's loan policy guidelines.

*Industry Concentrations.* As of December 31, 2013 and December 31, 2012, there were no concentrations of loans within any single industry in excess of 10 percent of total loans, as segregated by Standard Industrial Classification code ("SIC code"). The SIC code is a federally designed standard industrial numbering system used by the Company to categorize loans by the borrower's type of business.

*Collateral Concentrations.* Concentrations of credit risk can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries, or certain geographic regions. The Company has a concentration in real estate loans as well as a geographic concentration that could pose an adverse credit risk, particularly with the current economic downturn in the real estate market. At December 31, 2013, approximately 87.11 percent of the Company's loan portfolio was concentrated in loans secured by real estate. A substantial portion of borrowers' ability to honor their contractual obligations is dependent upon the viability of the real estate economic sector. The downturn of the housing and real estate market that began in 2007 resulted in an increase of problem loans secured by real estate. These loans are centered primarily in the Company's larger Metropolitan Statistical Area (MSA) markets. Declining collateral real estate values that secure land development, construction and speculative real estate loans in the Company's larger MSA markets have resulted in high loan loss provisions in the last several years. In addition, a large portion of the Company's foreclosed assets are also located in these same geographic markets, making the recovery of the carrying amount of foreclosed assets susceptible to changes in market conditions. Management continues to monitor these concentrations and has considered these concentrations in its allowance for loan loss analysis.

*Large Credit Relationships.* The Company is currently in eighteen counties in central, south and coastal Georgia and includes metropolitan markets in Dougherty, Lowndes, Houston, Chatham and Muscogee counties. As a result, the Company originates and maintains large credit relationships with several commercial customers in the ordinary course of business. The Company considers large credit relationships to be those with commitments equal to or in excess of \$5.0 million prior to any portion being sold. Large relationships also include loan participations purchased if the credit relationship with the agent is equal to or in excess of \$5.0 million. In addition to the Company's normal policies and procedures related to the origination of large credits, the Company's Executive Loan Committee and Director Loan Committee must approve all new and renewed credit facilities which are part of large credit relationships. The following table provides additional information on the Company's large credit relationships outstanding at December 31, 2013 and December 31, 2012.

	December 31, 2013			December 31, 2012		
	Number of Relationships	Period End Balances		Number of Relationships	Period End Balances	
		Committed	Outstanding		Committed	Outstanding
Large Credit Relationships:						
\$10 million and greater	1	\$10,023	\$10,023	1	\$10,276	\$10,276
\$5 million to \$9.9 million	11	76,306	69,672	13	88,248	72,179

*Maturities and Sensitivities of Loans to Changes in Interest Rates.* The following table presents the maturity distribution of the Company's loans at December 31, 2013. The table also presents the portion of loans that have fixed interest rates or variable interest rates that fluctuate over the life of the loans in accordance with changes in an interest rate index such as the prime rate.

	Due in One Year or Less	After One, but Within Three Years	After Three, but Within Five Years	After Five Years	Total
Loans with fixed interest rates	\$ 218,867	\$ 284,788	\$ 71,472	\$ 65,538	\$ 640,665
Loans with floating interest rates	101,736	7,215	273	1,329	110,553
Total	\$ 320,603	\$ 292,003	\$ 71,745	\$ 66,867	\$ 751,218

The Company may renew loans at maturity when requested by a customer whose financial strength appears to support such renewal or when such renewal appears to be in the Company's best interest. In such instances, the Company generally requires payment of accrued interest and may adjust the rate of interest, require a principal reduction or modify other terms of the loan at the time of renewal.

### Nonperforming Assets and Potential Problem Loans

Year-end nonperforming assets and accruing past due loans were as follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Loans Accounted for on Nonaccrual	<b>\$24,114</b>	\$29,851	\$38,822	\$28,902	\$33,535
Loans Past Due 90 Days or More	<b>4</b>	4	15	19	31
Other Real Estate Foreclosed	<b>15,502</b>	15,941	20,445	20,208	19,705
Securities Accounted for on Nonaccrual	<b>-</b>	366	426	132	132
Total Nonperforming Assets	<b><u>\$39,620</u></b>	<u>\$46,162</u>	<u>\$59,708</u>	<u>\$49,261</u>	<u>\$53,403</u>
Nonperforming Assets as a Percentage of:					
Total Loans and Foreclosed Assets	<b>5.17%</b>	6.05%	8.10%	5.91%	5.62%
Total Assets	<b>3.45%</b>	4.05%	4.99%	3.86%	4.09%
Supplemental Data:					
Trouble Debt Restructured Loans					
In Compliance with Modified Terms	<b>\$20,715</b>	\$24,870	\$29,839	\$26,556	\$9,269
Trouble Debt Restructured Loans					
Past Due 30-89 Days	<b>435</b>	1,377	611	1,048	459
Accruing Past Due Loans:					
30-89 Days Past Due	<b>9,366</b>	14,911	7,161	19,740	25,547
90 or More Days Past Due	<b>4</b>	4	15	19	31
Total Accruing Past Due Loans	<b><u>\$ 9,370</u></b>	<u>\$14,915</u>	<u>\$ 7,176</u>	<u>\$19,759</u>	<u>\$25,578</u>

Nonperforming assets include nonaccrual loans, loans past due 90 days or more, foreclosed real estate and nonaccrual securities. Nonperforming assets at December 31, 2013 decreased 14.2 percent from December 31, 2012.

Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due and/or management deems the collectibility of the principal and/or interest to be in question, as well as when required by regulatory requirements. Loans to a customer whose financial condition has deteriorated are considered for nonaccrual status whether or not the loan is 90 days or more past due. For consumer loans, collectibility and loss are generally determined before the loan reaches 90 days past due. Accordingly, losses on consumer loans are recorded at the time they are determined. Consumer loans that are 90 days or more past due are generally either in liquidation/payment status or bankruptcy awaiting confirmation of a plan. Once interest accruals are discontinued, accrued but uncollected interest is charged to current year operations. Subsequent receipts on nonaccrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Classification of a loan as nonaccrual does not preclude the ultimate collection of loan principal or interest.

Troubled debt restructured loans are loans on which, due to deterioration in the borrower's financial condition, the original terms have been modified in favor of the borrower or either principal or interest has been forgiven.

Foreclosed assets represent property acquired as the result of borrower defaults on loans. Foreclosed assets are recorded at estimated fair value, less estimated selling costs, at the time of foreclosure. Write-downs occurring at foreclosure are charged against the allowance for possible loan losses. On an ongoing basis, properties are appraised as required by market indications and applicable regulations. Write-downs are provided for subsequent declines in value and are included in other non-interest expense along with other expenses related to maintaining the properties.

### **Allowance for Loan Losses**

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The allowance for loan losses includes allowance allocations calculated in accordance with current U.S. accounting standards. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company's allowance for loan losses consists of specific valuation allowances established for probable losses on specific loans and historical valuation allowances, adjusted for qualitative factors, for other loans with similar risk characteristics.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of classified loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the subsidiary bank level and is reviewed at the parent Company level. Once a loan is classified, it is reviewed to determine whether the loan is impaired and, if impaired, a portion of the allowance for possible loan losses is specifically allocated to the loan. Specific valuation allowances are determined after considering the borrower's financial condition, collateral deficiencies, and economic conditions affecting the borrower's industry, among other things.

Historical valuation allowances are calculated from loss factors applied to loans with similar risk characteristics. The loss factors are based on loss ratios for groups of loans with similar risk characteristics. The loss ratios are derived from the proportional relationship between actual loan losses and the total population of loans in the risk category. The historical loss ratios are periodically updated based on actual charge-off experience. The Company's groups of similar loans include similarly risk-graded groups of loans not reviewed for individual impairment. In addition, the Company has also segmented its' real estate portfolio into thirteen separate categories and captured loan loss experience for each category. Most of the Company's charge-offs the past two years have been real estate dependent loans and we believe this segmentation provides more accuracy in determining allowance for loan loss adequacy. During first quarter 2012, management refined the Company's methodology used in estimating the amount of the Allowance for Loan and Lease Losses (ALLL) which is defined in the notes to the financial statements. The effect of these changes on the ALLL during 2012 resulted in a reduction in the ALLL estimate of \$2,154,639 for December 31, 2012 compared to December 31, 2011. Management believes the adjustments made will result in a better estimation of losses incurred in the portfolio.

Management evaluates the adequacy of the allowance for each of these components on a quarterly basis. Peer comparisons, industry comparisons, and regulatory guidelines are also used in the determination of the general valuation allowance.

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

An allocation for loan losses has been made according to the respective amounts deemed necessary to provide for the possibility of incurred losses within the various loan categories. The allocation is based primarily on previous charge-off experience adjusted for changes in experience among each category. Additional amounts are allocated by evaluating the loss potential of individual loans that management has considered impaired. The reserve for loan loss allocation is subjective since it is based on judgment and estimates, and therefore is not necessarily indicative of the specific amounts or loan categories in which the charge-offs may ultimately occur. The following table shows a comparison of the allocation of the reserve for loan losses for the periods indicated.

	2013		2012		2011		2010		2009	
	Reserve	%*	Reserve	%*	Reserve	%*	Reserve	%*	Reserve	%*
Commercial, Financial and Agricultural	\$ 1,311	8%	\$ 1,277	8%	\$ 1,368	8%	\$ 5,113	8%	\$ 4,710	9%
Real Estate - Construction	1,920	8	2,028	8	3,261	9	4,646	9	7,850	12
Real Estate - Farmland	312	6	291	7	365	7	944	7	942	6
Real Estate - Other	7,658	73	8,569	72	10,143	71	13,972	70	13,816	67
Loans to Individuals	243	3	228	4	205	4	3,074	4	2,826	4
All Other Loans	362	2	344	1	308	1	531	2	1,257	2
Total	<u>\$ 11,806</u>	<u>100%</u>	<u>\$12,737</u>	<u>100%</u>	<u>\$15,650</u>	<u>100%</u>	<u>\$28,280</u>	<u>100%</u>	<u>\$31,401</u>	<u>100%</u>

\* Percentage represents the loan balance in each category expressed as a percentage of total end of period loans.

Activity in the allowance for loan losses is presented in the following table. There were no charge-offs or recoveries related to foreign loans during any of the periods presented.



The following table presents an analysis of the Company's loan loss experience for the periods indicated.

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Allowance for Loan Losses at Beginning of Year	<b><u>\$12,737</u></b>	<u>\$15,650</u>	<u>\$28,280</u>	<u>\$31,401</u>	<u>\$17,016</u>
Charge-Offs					
Commercial, Financial and Agricultural	<b>155</b>	656	1,297	725	768
Real Estate	<b>5,671</b>	9,618	21,215	15,309	27,545
Consumer	<b>398</b>	169	223	549	908
All Other	<b>4</b>	11	115	1,040	272
	<b><u>6,228</u></b>	<u>10,454</u>	<u>22,850</u>	<u>17,623</u>	<u>29,493</u>
Recoveries					
Commercial, Financial and Agricultural	<b>62</b>	140	582	82	73
Real Estate	<b>638</b>	494	1,235	774	156
Consumer	<b>94</b>	82	145	246	191
All Other	<b>18</b>	40	8	50	13
	<b><u>812</u></b>	<u>756</u>	<u>1,970</u>	<u>1,152</u>	<u>433</u>
Net Charge-Offs	<b><u>5,416</u></b>	<u>9,698</u>	<u>20,880</u>	<u>16,471</u>	<u>29,060</u>
Provision for Loans Losses	<b><u>4,485</u></b>	<u>6,785</u>	<u>8,250</u>	<u>13,350</u>	<u>43,445</u>
Allowance for Loan Losses at End of Year	<b><u>\$11,806</u></b>	<u>\$12,737</u>	<u>\$15,650</u>	<u>\$28,280</u>	<u>\$31,401</u>
Ratio of Net Charge-Offs to Average Loans	<b><u>0.73%</u></b>	<u>1.34%</u>	<u>2.74%</u>	<u>1.90%</u>	<u>3.02%</u>

The allowance for loan losses is maintained at a level considered appropriate by management, based on estimated probable losses within the existing loan portfolio. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The provision for loan losses reflects loan quality trends, including the level of net charge-offs or recoveries, among other factors. The provision for loan losses decreased \$2.30 million from \$6.79 million in 2012 to \$4.49 million in 2013. The provision for loan losses charged to earnings was based upon management's judgment of the amount necessary to maintain the allowance at an adequate level to absorb losses inherent in the loan portfolio at year end. The amount each period is dependent upon many factors, including changes in the risk ratings of the loan portfolio, net charge-offs, past due ratios, the value of collateral, and other environmental factors that include portfolio loan quality indicators; portfolio growth and composition of commercial real estate and concentrations; portfolio policies, procedures, underwriting standards, loss recognition, collection and recovery practices; local economic business conditions; and the experience, ability, and depth of lending management and staff. Of significance to changes in the allowance during 2013 was the reduction in the net charge-offs in 2013 to \$5.42 million from \$9.70 million in 2012. The Company believes that collection efforts have reduced impaired loans and the reduction in net charge-offs runs parallel with the improvement in the substandard assets. As we begin to see stabilization in the economy and the housing and real estate market, we expect continued improvement in our substandard assets, including net charge-offs.

Provisions continue to be higher than normal primarily due to the elevated risk of residential real estate and land development loans that began during 2007 with the housing and real estate downturn. Nonperforming assets as a percentage of total loans and foreclosed assets decreased to 5.17 percent at December 31, 2013 compared to 6.05 percent at December 31, 2012. Total nonperforming assets at December 31, 2013 were \$39.6 million, of which \$17.3 million were construction, land development and other land loans; \$1.6 million were farmland properties; \$5.9 million were 1-4 family residential properties; \$0.3 million were multifamily properties; \$12.5 million were nonfarm nonresidential properties; and the remainder of nonperforming assets totaling \$2.0 million were commercial and consumer loans. Total nonperforming assets at December 31, 2012 were \$46.2 million, of which \$23.9 million were construction, land development and other land loans; \$7.2 million were 1-4 family residential properties; \$0.6 million were multifamily properties; \$10.4 million were nonfarm nonresidential properties; \$2.4 million were farmland properties; and the remainder of nonperforming assets totaling \$1.7 million were commercial and consumer loans. All of the classified loans greater than \$250 thousand, including the nonperforming loans, are reviewed each quarter for impairment. The allowance for loan losses of \$11.8 million at December 31, 2013 was 1.57 percent of total loans which compares to \$12.7 million at December 31, 2012, or 1.70 percent of total loans and to \$15.6 million at December 31, 2011, or 2.18 percent. Unusually high levels of loan loss provision have been required over the past few years as Company management addresses asset quality deterioration. While the nonperforming loans as a percentage of total loans was 3.21 percent, 4.00 percent, and 5.42 percent, respectively, as of December 31, 2013, December 31, 2012 and December 31, 2011, the Company's allowance for loan losses as a percentage of nonperforming loans was 48.96 percent, 42.66 percent, and 40.29 percent, respectively as of December 31, 2013, December 31, 2012 and December 31, 2011. We continue to identify new problem loans, even though we have less problem loans than the previous year.

While the allowance for loan losses decreased from \$12.74 million, or 1.70 percent of total loans at December 31, 2012 to \$11.81 million, or 1.57 percent of total loans at December 31, 2013, the Company also reflected a decrease in nonperforming loans from \$29.86 million at December 31, 2012 to \$24.11 million at December 31, 2013. When a loan is performing, it is accounted for under the Company's general loan loss reserve methodology. Once the loan becomes impaired, it is removed from the pool of loans covered by the general reserve and reviewed individually for exposure. In cases where the individual review reveals no exposure, no reserve is recorded for that loan, either through an individual reserve or through a general reserve. If, however, the individual review of the loan does indicate some exposure, management often charges off this exposure, rather than recording a specific reserve. In these instances, a loan which becomes nonperforming could actually reduce the allowance for loan losses. The allowance for loan losses is inherently judgmental, nevertheless the Company's methodology is consistently applied based on standards for current accounting by creditors for impairment of a loan and allowance allocations determined in accordance with accounting for contingencies. Loans individually selected for impairment review consist of all loans classified substandard that are \$250 thousand and over. The remaining portfolio is analyzed based on historical loss data. Historical loss rates are updated annually to provide the annual loss rate which is applied to the appropriate portfolio grades. In addition, the Company has also segmented its real estate portfolio into thirteen separate categories and captured loan loss experience for each category. Most of the Company's charge-offs during the past four years have been real estate dependent loans and we believe this segmentation provides more accuracy in determining allowance for loan loss adequacy.

In addition, environmental factors as discussed earlier are evaluated for any adjustments needed to the allowance for loan losses determination produced by individual loan impairment analysis and remaining portfolio segmentation analysis. The allowance for loan losses determination is based on individual loan reviews throughout the year and an environmental analysis at quarter-end.

As part of our monitoring and evaluation of collateral values for nonperforming and problem loans in determining adequate allowance for loan losses, regional credit officers along with lending officers submit monthly problem loan reports for loans greater than \$250 thousand in which impairment is identified. This process typically determines collateral shortfall based upon local market real estate value estimates should the collateral be liquidated. Once the loan is deemed uncollectible, it is transferred to our problem loan department for workout, foreclosure and/or liquidation. The problem loan department gets a current appraisal on the property in order to record a fair market value (less selling expenses) when the property is foreclosed on and moved into other real estate. Trends the past several quarters reflect a decrease in collateral values from two to three years ago on improved properties of fifteen to twenty five percent and on land development and land loans of thirty to fifty percent.

The allowance for loan losses is \$931 thousand less than the prior year end, after factoring in net charge-offs, additional provisions, and the normal determination for an adequate funding level. Restructuring of some substandard and non-performing loans during 2013 has resulted in significant charge-offs, but a strategy deemed prudent in bringing resolution with these credits and a return to performing status in the future. Management believes the level of the allowance for loan losses was adequate as of December 31, 2013. Should any of the factors considered by management in evaluating the adequacy of the allowance for loan losses change, the Company's estimate of probable loan losses could also change, which could affect the level of future provisions for loan losses.

## Investment Portfolio

The following table presents carrying values of investment securities held by the Company as of December 31, 2013, 2012 and 2011.

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Obligations of States and Political Subdivisions	\$ 3,947	\$ 4,046	\$ 7,630
Corporate Obligations	-	1,105	2,114
Asset-Backed Securities	-	132	132
Investment Securities	<b>3,947</b>	5,283	9,876
Mortgage-Backed Securities	<b>259,348</b>	263,059	294,061
Total Investment Securities and Mortgage-Backed Securities	<b><u>\$263,295</u></b>	<b><u>\$268,342</u></b>	<b><u>\$303,937</u></b>

The following table represents expected maturities and weighted-average yields of investment securities held by the Company as of December 31, 2013. (Mortgage-backed securities are based on the average life at the projected speed, while State and Political Subdivisions and Corporate Obligations reflect anticipated calls being exercised.)

	Within 1 Year		After 1 Year But Within 5 Years		After 5 Years But Within 10 Years		After 10 Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Mortgage-Backed Securities	\$ -	- %	\$ 66,241	1.39%	\$ 181,452	1.73%	\$ 11,655	2.41%
Obligations of State and Political Subdivisions	790	3.75%	1,711	3.04%	1,446	2.06%	-	- %
Total Investment Portfolio	<u>\$ 790</u>	<u>3.75%</u>	<u>\$ 67,952</u>	<u>1.43%</u>	<u>\$ 182,898</u>	<u>1.73%</u>	<u>\$ 11,655</u>	<u>2.41%</u>

Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income. The Company has 99.9 percent of its portfolio classified as available for sale.

At December 31, 2013, there were no holdings of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10 percent of the Company's shareholders' equity.

The average yield of the securities portfolio was 1.36 percent in 2013 compared to 1.82 percent in 2012 and 2.39 percent in 2011. The decrease in the average yield from 2013 to 2012 and from 2011 to 2012 primarily resulted from the turnover of the securities portfolio resulting in the investment of new funds at lower rates.

## Deposits

The following table presents the average amount outstanding and the average rate paid on deposits by the Company for the years 2013, 2012 and 2011.

	2013		2012		2011	
	Average Amount	Average Rate	Average Amount	Average Rate	Average Amount	Average Rate
Noninterest-Bearing Demand Deposits	\$ 112,667		\$ 101,896		\$ 93,903	
Interest-Bearing Demand and Savings Time Deposits	366,974	0.36%	329,984	0.38%	273,783	0.45%
	473,672	0.95%	537,810	1.39%	633,033	1.85%
Total Deposits	<u>\$ 953,313</u>	<u>0.61%</u>	<u>\$ 969,690</u>	<u>0.90%</u>	<u>\$ 1,000,719</u>	<u>1.29%</u>

The following table presents the maturities of the Company's other time deposits as of December 31, 2013.

	<b>Other Time Deposits \$100,000 or Greater</b>	<b>Other Time Deposits Less Than \$100,000</b>	<b>Total</b>
Months to Maturity			
3 or Less	\$ 35,549	\$ 53,181	\$ 88,730
Over 3 through 6	33,331	40,562	73,893
Over 6 through 12	74,509	85,839	160,348
Over 12 Months	77,284	60,628	137,912
	<u>\$220,673</u>	<u>\$240,210</u>	<u>\$460,883</u>

Average deposits decreased \$16.38 million in 2013 compared to 2012 and decreased \$31.03 million in 2012 compared to 2011. The decrease in 2013 included \$64.14 million, or 11.93 percent in time deposits while, at the same time, noninterest bearing deposits increased \$10.77 million, or 10.57 percent and interest-bearing demand and savings deposits increased \$36.99 million, or 11.21 percent. The decrease in 2012 included \$95.22 million, or 15.04 percent in time deposits while, at the same time, noninterest bearing deposits increased \$10.77 million, or 10.57 percent and interest-bearing demand and savings deposits increased \$56.20 million, or 11.21 percent. Accordingly, the ratio of average noninterest-bearing deposits to total average deposits was 11.82 in 2013, 10.51 percent in 2012 and 9.4 percent in 2011. The general decrease in market rates in 2013 had the effect of (i) decreasing the average cost of interest-bearing deposits by 32 basis points in 2013 compared to 2012 and (ii) mitigating a portion of the impact of decreasing yields on earning assets in the Company's net interest income in 2013. The general decrease in market rates in 2012 had the effect of (i) decreasing the average cost of interest-bearing deposits by 42 basis points in 2012 compared to 2011 and (ii) mitigating a portion of the impact of decreasing yields on earning assets in the Company's net interest income in 2012.

Total average interest-bearing deposits decreased \$27.1 million, or 3.1 percent in 2013 compared to 2012 and decreased \$39.0 million, or 4.3 percent in 2012 compared to 2011. The decrease in average deposits in 2013 compared to 2012 was time deposit accounts.

The Company supplements deposit sources with brokered deposits. As of December 31, 2013, the Company had \$26.6 million, or 2.69 percent of total deposits, in brokered certificates of deposit attracted by external third parties. Additional information is provided in the Notes to Consolidated Financial Statements for Deposits.

## Off-Balance-Sheet Arrangements, Commitments, Guarantees, and Contractual Obligations

The following table summarizes the Company's contractual obligations and other commitments to make future payments as of December 31, 2013. Payments for borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts. Loan commitments and standby letters of credit are presented at contractual amounts; however, since many of these commitments are expected to expire unused or only partially used, the total amounts of these commitments do not necessarily reflect future cash requirements.

	<u>Payments Due by Period</u>				<u>Total</u>
	<u>1 Year or Less</u>	<u>More than 1 Year but Less Than 3 Years</u>	<u>3 Years or More but Less Than 5 Years</u>	<u>5 Years or More</u>	
Contractual Obligations:					
Subordinated Debentures	\$ -	\$ -	\$ -	\$ 24,229	\$ 24,229
Federal Home Loan Bank Advances	-	-	9,000	31,000	40,000
Operating Leases	53	84	39	-	176
Deposits with Stated Maturity Dates	322,971	106,946	30,660	306	460,883
	<u>323,024</u>	<u>107,030</u>	<u>39,699</u>	<u>55,535</u>	<u>525,288</u>
Other Commitments:					
Loan Commitments	65,688	-	-	-	65,688
Standby Letters of Credit	1,411	-	-	-	1,411
	<u>67,099</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>67,099</u>
Total Contractual Obligations and Other Commitments	<u>\$390,123</u>	<u>\$107,030</u>	<u>\$39,699</u>	<u>\$ 55,535</u>	<u>\$592,387</u>

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments which are not reflected in the consolidated financial statements. These instruments include commitments to extend credit, standby letters of credit, performance letters of credit, guarantees and liability for assets held in trust.

Such financial instruments are recorded in the financial statements when funds are disbursed or the instruments become payable. The Company uses the same credit policies for these off-balance sheet financial instruments as they do for instruments that are recorded in the consolidated financial statements.

*Loan Commitments.* The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Company's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for possible loan losses.

Loan commitments outstanding at December 31, 2013 are included in the preceding table.

*Standby Letters of Credit.* Letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Company would be entitled to seek recovery from the customer. The Company's policies generally require that standby letters of credit arrangements contain security and debt covenants similar to those contained in loan agreements. Standby letters of credit outstanding at December 31, 2013 are included in the preceding table.

## **Capital and Liquidity**

At December 31, 2013, shareholders' equity totaled \$90.0 million compared to \$95.8 million at December 31, 2012. In addition to net income of \$4.6 million, other significant changes in shareholders' equity during 2013 included \$1.5 million of dividends declared on preferred stock. The accumulated other comprehensive loss component of shareholders' equity totaled \$(9.1) million at December 31, 2013 compared to \$(150) thousand at December 31, 2012. This fluctuation was mostly related to the after-tax effect of changes in the fair value of securities available for sale. Under regulatory requirements, the unrealized gain or loss on securities available for sale does not increase or reduce regulatory capital and is not included in the calculation of risk-based capital and leverage ratios. Regulatory agencies for banks and bank holding companies utilize capital guidelines designed to measure Tier 1 and total capital and take into consideration the risk inherent in both on-balance sheet and off-balance sheet items. Tier 1 capital consists of common stock and qualifying preferred stockholders' equity less goodwill and disallowed deferred tax assets. Tier 2 capital consists of certain convertible, subordinated and other qualifying debt and the allowance for loan losses up to 1.25 percent of risk-weighted assets. The Company has no Tier 2 capital other than the allowance for loan losses.

Using the capital requirements presently in effect, the Tier 1 ratio as of December 31, 2013 was 15.81 percent and total Tier 1 and 2 risk-based capital was 17.06 percent. Both of these measures compare favorably with the regulatory minimum of 4 percent for Tier 1 and 8 percent for total risk-based capital. The Company's Tier 1 leverage ratio as of December 31, 2013 was 10.57 percent, which exceeds the required ratio standard of 4 percent.

For 2013, average capital was \$93.4 million, representing 8.35 percent of average assets for the year. This compares to 8.47 percent for 2012.

The Company did not pay any common stock dividends in 2013 or 2012. The Company suspended dividend payments beginning in the third quarter of 2009.

The Company declared dividends of \$1,509 and \$1,435 on preferred stock during 2013 and 2012, respectively. The Company deferred all dividend payments declared in 2013 on its preferred stock, as well as all interest payments on its TRUPS in order to preserve cash at the holding company level. The Company had no preferred stock until January 2009 when shares were issued to U.S. Treasury.

The Company, primarily through the actions of its subsidiary bank, engages in liquidity management to ensure adequate cash flow for deposit withdrawals, credit commitments and repayments of borrowed funds. Needs are met through loan repayments, net interest and fee income and the sale or maturity of existing assets. In addition, liquidity is continuously provided through the acquisition of new deposits, the renewal of maturing deposits and external borrowings.

Management monitors deposit flow and evaluates alternate pricing structures to retain and grow deposits. To the extent needed to fund loan demand, traditional local deposit funding sources are supplemented by the use of FHLB borrowings, brokered deposits and other wholesale deposit sources outside the immediate market area. Internal policies have been updated to monitor the use of various core and non-core funding sources, and to balance ready access with risk and cost. Through various asset/liability management strategies, a balance is maintained among goals of liquidity, safety and earnings potential. Internal policies that are consistent with regulatory liquidity guidelines are monitored and enforced by the Bank.

The investment portfolio provides a ready means to raise cash if liquidity needs arise. As of December 31, 2013, the available for sale bond portfolio totaled \$263.3 million. At December 31, 2012, the Company held \$268.3 million in bonds (excluding FHLB stock), at current market value in the available for sale portfolio. Only marketable investment grade bonds are purchased. Although most of the Banks' bond portfolios are encumbered as pledges to secure various public funds deposits, repurchase agreements, and for other purposes, management can restructure and free up investment securities for a sale if required to meet liquidity needs.

Management continually monitors the relationship of loans to deposits as it primarily determines the Company's liquidity posture. Colony had ratios of loans to deposits of 76.1 percent as of December 31, 2013 and 76.3 percent as of December 31, 2012. Management employs alternative funding sources when deposit balances will not meet loan demands. The ratios of loans to all funding sources (excluding Subordinated Debentures) at December 31, 2013 and December 31, 2012 were 73.1 percent and 73.6 percent, respectively. Management continues to emphasize programs to generate local core deposits as our Company's primary funding sources. The stability of the Banks' core deposit base is an important factor in Colony's liquidity position. A heavy percentage of the deposit base is comprised of accounts of individuals and small businesses with comprehensive banking relationships and limited volatility. At December 31, 2013 and December 31, 2012, the Bank had \$221 million and \$211 million, respectively, in certificates of deposit of \$100,000 or more. These larger deposits represented 22.3 percent and 21.6 percent of respective total deposits. Management seeks to monitor and control the use of these larger certificates, which tend to be more volatile in nature, to ensure an adequate supply of funds as needed. Relative interest costs to attract local core relationships are compared to market rates of interest on various external deposit sources to help minimize the Company's overall cost of funds.



The Company supplemented deposit sources with brokered deposits. As of December 31, 2013, the Company had \$26.6 million, or 2.7 percent of total deposits, in brokered certificates of deposit attracted by external third parties. Additionally, the bank uses external wholesale or Internet services to obtain out-of-market certificates of deposit at competitive interest rates when funding is needed. As of December 31, 2013, the Company had \$24.1 million, or 2.4 percent of total deposits, in external wholesale or internet network deposits.

To plan for contingent sources of funding not satisfied by both local and out-of-market deposit balances, Colony and its subsidiary have established multiple borrowing sources to augment their funds management. The Company has borrowing capacity through membership of the Federal Home Loan Bank program. The bank has also established overnight borrowing for Federal Funds Purchased through various correspondent banks. Management believes the various funding sources discussed above are adequate to meet the Company's liquidity needs in the future without any material adverse impact on operating results.

Liquidity measures the ability to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects its ability to meet loan requests, to accommodate possible outflows in deposits and to take advantage of interest rate market opportunities. The ability of a financial institution to meet its current financial obligations is a function of balance sheet structure, the ability to liquidate assets, and the availability of alternative sources of funds. The Company seeks to ensure its funding needs are met by maintaining a level of liquid funds through asset/liability management.

Asset liquidity is provided by liquid assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash, interest-bearing deposits in banks, securities available for sale, maturities and cash flow from securities held to maturity, and federal funds sold and securities purchased under resale agreements.

Liability liquidity is provided by access to funding sources which include core deposits. Should the need arise, the Company also maintains relationships with the Federal Home Loan Bank, Federal Reserve Bank, two correspondent banks and repurchase agreement lines that can provide funds on short notice.

Since Colony is a bank holding Company and does not conduct operations, its primary sources of liquidity are dividends up streamed from the subsidiary bank and borrowings from outside sources.

The liquidity position of the Company is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. Management is not aware of any events that are reasonably likely to have a material adverse effect on the Company's liquidity, capital resources or operations. In addition, management is not aware of any regulatory recommendations regarding liquidity, which if implemented, would have a material adverse effect on the Company.

## **Impact of Inflation and Changing Prices**

The Company's financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). GAAP presently requires the Company to measure financial position and operating results primarily in terms of historic dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on the operations of the Company is reflected in increased operating costs. In management's opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the inflation rate. Interest rates are highly sensitive to many factors that are beyond the control of the Company, including changes in the expected rate of inflation, the influence of general and local economic conditions and the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities, among other things, as further discussed in the next section.

## **Regulatory and Economic Policies**

The Company's business and earnings are affected by general and local economic conditions and by the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities, among other things. The Federal Reserve Board regulates the supply of money in order to influence general economic conditions. Among the instruments of monetary policy available to the Federal Reserve Board are (i) conducting open market operations in United States government obligations, (ii) changing the discount rate on financial institution borrowings, (iii) imposing or changing reserve requirements against financial institution deposits, and (iv) restricting certain borrowings and imposing or changing reserve requirements against certain borrowing by financial institutions and their affiliates. These methods are used in varying degrees and combinations to affect directly the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits. For that reason alone, the policies of the Federal Reserve Board have a material effect on the earnings of the Company.

Governmental policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future; however, the Company cannot accurately predict the nature, timing or extent of any effect such policies may have on its future business and earnings.

## **Recently Issued Accounting Pronouncements**

See Note 1 - Summary of Significant Accounting Policies under the section headed Changes in Accounting Principles and Effects of New Accounting Pronouncements included in the Notes to Consolidated Financial Statements.

## Quantitative and Qualitative Disclosures About Market Risk

### AVERAGE BALANCE SHEETS

	2013			2012			2011		
	Average Balances	Income/Expense	Yields/Rates	Average Balances	Income/Expense	Yields/Rates	Average Balances	Income/Expense	Yields/Rates
Assets									
Interest-Earning Assets									
Loans, Net of Unearned Income (1)	\$ 744,627	\$ 41,473	5.57%	\$ 721,872	\$ 42,054	5.83%	\$ 763,067	\$ 44,593	5.84%
Investment Securities									
Taxable	272,818	3,597	1.32	280,959	5,005	1.78	296,948	7,012	2.36
Tax-Exempt (2)	2,871	139	4.84	3,302	155	4.69	3,345	171	5.11
Total Investment Securities	275,689	3,736	1.36	284,261	5,160	1.82	300,293	7,183	2.39
Interest-Bearing Deposits	9,625	81	0.84	17,046	77	0.45	18,715	47	0.25
Federal Funds Sold	14,969	39	0.26	38,877	99	0.25	44,667	115	0.26
Other Interest-Earning Assets	3,275	27	0.82	4,277	43	1.01	5,781	46	0.80
Total Interest-Earning Assets	1,048,185	45,356	4.33	1,066,333	47,433	4.45	1,132,523	51,984	4.59
Noninterest-Earning Assets									
Cash	19,401			18,474			19,057		
Allowance for Loan Losses	(13,347)			(15,781)			(20,585)		
Other Assets	63,832			70,788			74,896		
Total Noninterest-Earning Assets	69,886			73,481			73,368		
Total Assets	\$ 1,118,071			\$ 1,139,814			\$ 1,205,891		
Liabilities and Stockholders' Equity									
Interest-Bearing Liabilities									
Interest-Bearing Demand and Savings	\$ 366,974	\$ 1,335	0.36%	\$ 329,984	\$ 1,258	0.38%	\$ 273,783	\$ 1,232	0.45%
Other Time	473,672	4,486	0.95	537,810	7,479	1.39	633,033	11,718	1.85
Total Interest-Bearing Deposits	840,646	5,821	0.69	867,794	8,737	1.01	906,816	12,950	1.43
Other Interest-Bearing Liabilities									
Other Borrowed Money	40,299	1,159	2.88	43,745	1,725	3.94	71,720	3,010	4.20
Subordinated Debentures	24,229	517	2.13	24,229	554	2.29	24,229	508	2.10
Federal Funds Purchased and Repurchase Agreements	34	-	-	-	-	-	9,851	338	3.43
Total Other Interest-Bearing Liabilities	64,562	1,676	2.6	67,974	2,279	3.35	105,800	3,856	3.64
Total Interest-Bearing Liabilities	905,208	7,497	0.83	935,768	11,016	1.18	1,012,616	16,806	1.66
Noninterest-Bearing Liabilities and Stockholders' Equity									
Demand Deposits	112,667			101,896			93,903		
Other Liabilities	6,838			5,609			4,635		
Stockholders' Equity	93,358			96,541			94,737		
Total Noninterest-Bearing Liabilities and Stockholders' Equity	212,863			204,046			193,275		
Total Liabilities and Stockholders' Equity	\$ 1,118,071			\$ 1,139,814			\$ 1,205,891		
Interest Rate Spread			3.50%			3.27%			2.93%
Net Interest Income		\$ 37,859			\$ 36,417			\$ 35,178	
Net Interest Margin			3.61%			3.41%			3.11%

- (1) The average balance of loans includes the average balance of nonaccrual loans. Income on such loans is recognized and recorded on the cash basis. Taxable equivalent adjustments totaling \$123, \$91 and \$133 for 2013, 2012 and 2011 respectively, are included in interest on loans. The adjustments are based on a federal tax rate of 34 percent.
- (2) Taxable-equivalent adjustments totaling \$47, \$53 and \$58 for 2013, 2012 and 2011 respectively, are included in tax-exempt interest on investment securities. The adjustments are based on a federal tax rate of 34 percent with appropriate reductions for the effect of disallowed interest expense incurred in carrying tax-exempt obligations.

**Colony Bankcorp, Inc. and Subsidiaries**  
**Interest Rate Sensitivity**

The following table is an analysis of the Company's interest rate-sensitivity position at December 31, 2013. The interest-bearing rate-sensitivity gap, which is the difference between interest-earning assets and interest-bearing liabilities by repricing period, is based upon maturity or first repricing opportunity, along with a cumulative interest rate-sensitivity gap. It is important to note that the table indicates a position at a specific point in time and may not be reflective of positions at other times during the year or in subsequent periods. Major changes in the gap position can be, and are, made promptly as market outlooks change.

	<b>Assets and Liabilities Repricing Within</b>					<b>Total</b>
	<b>3 Months or Less</b>	<b>4 to 12 Months</b>	<b>1 Year</b>	<b>1 to 5 Years</b>	<b>Over 5 Years</b>	
<b>EARNING ASSETS:</b>						
Interest-Bearing Deposits	\$ 21,960	\$ -	\$ 21,960	\$ -	\$ -	\$ 21,960
Federal Funds Sold	20,495	-	20,495	-	-	20,495
Investment Securities	-	274	274	62,135	200,886	263,295
Loans, Net of Unearned Income	185,440	134,983	320,423	363,568	66,867	750,858
Other Interest- Earning Assets	3,164	-	3,164	-	-	3,164
<b>Total Interest-Earning Assets</b>	<b>231,059</b>	<b>135,257</b>	<b>366,316</b>	<b>425,703</b>	<b>267,753</b>	<b>1,059,772</b>
<b>INTEREST-BEARING LIABILITIES:</b>						
Interest-Bearing Demand Deposits (1)	357,291	-	357,291	-	-	357,291
Savings (1)	54,095	-	54,095	-	-	54,095
Time Deposits	88,730	234,241	322,971	137,606	306	460,883
Other Borrowings (2)	-	-	-	9,000	31,000	40,000
Subordinated Debentures	24,229	-	24,229	-	-	24,229
<b>Total Interest-Bearing Liabilities</b>	<b>524,345</b>	<b>234,241</b>	<b>758,586</b>	<b>146,606</b>	<b>31,306</b>	<b>936,498</b>
<b>Interest Rate-Sensitivity Gap</b>	<b>(293,286)</b>	<b>(98,984)</b>	<b>(392,270)</b>	<b>279,097</b>	<b>236,447</b>	<b>\$123,274</b>
<b>Cumulative Interest-Sensitivity Gap</b>	<b>\$(293,286)</b>	<b>\$(392,270)</b>	<b>\$(392,270)</b>	<b>\$(113,173)</b>	<b>\$123,274</b>	
<b>Interest Rate-Sensitivity Gap as a Percentage of Interest-Earning Assets</b>	<b>(27.67)%</b>	<b>(9.34)%</b>	<b>(37.01)%</b>	<b>26.34%</b>	<b>22.31%</b>	
<b>Cumulative Interest Rate-Sensitivity as a Percentage of Interest-Earning Assets</b>	<b>(27.67)%</b>	<b>(37.01)%</b>	<b>(37.01)%</b>	<b>(10.68)%</b>	<b>11.63%</b>	

(1) Interest-bearing Demand and Savings Accounts for repricing purposes are considered to reprice within 3 months or less.

(2) Short-term borrowings for repricing purposes are considered to reprice within 3 months or less.

The foregoing table indicates that we had a one year negative gap of \$392 thousand, or 37.01 percent of total interest-earning assets at December 31, 2013. In theory, this would indicate that at December 31, 2013, \$392 thousand more in liabilities than assets would reprice if there were a change in interest rates over the next 365 days. Thus, if interest rates were to decline, the gap would indicate a resulting increase in net interest margin. However, changes in the mix of earning assets or supporting liabilities can either increase or decrease the net interest margin without affecting interest rate sensitivity. In addition, the interest rate spread between an asset and our supporting liability can vary significantly while the timing of repricing of both the assets and our supporting liability can remain the same, thus impacting net interest income. This characteristic is referred to as a basis risk and, generally, relates to the repricing characteristics of short-term funding sources such as certificates of deposits.

Gap analysis has certain limitations. Measuring the volume of repricing or maturing assets and liabilities does not always measure the full impact on the portfolio value of equity or net interest income. Gap analysis does not account for rate caps on products; dynamic changes such as increasing prepay speeds as interest rates decrease, basis risk, or the benefit of non-rate funding sources. The majority of our loan portfolio reprices quickly and completely following changes in market rates, while non-term deposit rates in general move slowly and usually incorporate only a fraction of the change in rates. Products categorized as nonrate sensitive, such as our noninterest-bearing demand deposits, in the gap analysis behave like long term fixed rate funding sources. Both of these factors tend to make our actual behavior more asset sensitive than is indicated in the gap analysis. In fact, we experience higher net interest income when rates rise, opposite what is indicated by the gap analysis. Therefore, management uses gap analysis, net interest margin analysis and market value of portfolio equity as our primary interest rate risk management tools.

The Company utilizes FTN Financial Asset/Liability Management Analysis for a more dynamic analysis of balance sheet structure. The Company has established earnings at risk for net interest income in a +/- 200 basis point rate shock to be no more than a fifteen percent percentage change. The most recent analysis as of December 31, 2013 indicates that net interest income would deteriorate 4.99 percent with a 200 basis point decrease and would deteriorate 2.73 percent with a 200 basis point increase. The Company has established equity at risk in a +/- 200 basis point rate shock to be no more than a 20 percent percentage change. The most recent analysis as of December 31, 2013 indicates that net economic value of equity percentage change would increase 6.22 percent with a 200 basis point increase and would decrease 12.55 percent with a 200 basis point decrease. The Company has established its one year gap to be 80 percent to 120 percent. The most recent analysis as of December 31, 2013 indicates a one year gap of 0.83 percent. The analysis reflects slight net interest margin compression in both a declining and increasing interest rate environment. Given that interest rates have basically “bottomed-out” with the recent Federal Reserve action, the Company is anticipating interest rates to increase in the future though we believe that interest rates will remain flat most of 2014. The Company is focusing on areas to minimize margin compression in the future by minimizing longer term fixed rate loans, shortening on the yield curve with investments, securing longer term FHLB advances, securing certificates of deposit for longer terms and focusing on reduction of nonperforming assets.

## Return on Assets and Stockholder's Equity

The following table presents selected financial ratios for each of the periods indicated.

	Years Ended December 31		
	2013	2012	2011
Return on Average Assets(1)	<b>0.28%</b>	0.11%	0.09%
Return on Average Equity(1)	<b>3.34%</b>	1.25%	1.20%
Equity to Assets	<b>7.83%</b>	8.40%	8.08%
Dividends Declared	<b>\$0.00</b>	\$0.00	\$0.00

(1) Computed using net income available to common shareholders.

## Future Outlook

During the past four years, the financial services industry experienced tremendous adversities as a result of the collapse of the real estate markets across the country. Colony, like most banking companies, has been affected by these economic challenges that started with a rapid stall of real estate sales and development throughout the country. Focus during 2013 and again in 2014 will be directed toward addressing and bringing resolution to problem assets.

In response to the elevated risk of residential real estate and land development loans, management has extensively reviewed our loan portfolio with a particular emphasis on our residential and land development real estate exposure. Senior management with experience in problem loan workouts have been identified and assigned responsibility to oversee the workout and resolution of problem loans. The Company will continue to closely monitor our real estate dependent loans throughout the Company and focus on asset quality during this economic downturn.

Revenue enhancement initiatives to improve core non-interest income should be realized during 2014. These initiatives include new product lines and services.

## Business

### Regulatory Action

On October 21, 2010, the Board of Directors of the Company's subsidiary bank, Colony Bank (the "Bank"), received notification from its primary regulators, the Georgia Department of Banking and Finance ("the Georgia Department") and the FDIC that the Bank's latest examination results require a program of corrective action as outlined in a proposed Memorandum of Understanding ("MOU"). An MOU is characterized by the supervising authorities as an informal action that is neither published nor made publically available by the supervising authorities and is used when circumstances do not warrant formal supervisory action. An MOU is not a "written agreement" for purposes of Section 8 of the Federal Deposit Insurance Act. The Board of Directors entered into the MOU at its regularly scheduled monthly meeting on November 16, 2010 with the effective date of the MOU being November 23, 2010.

The MOU requires the Bank to develop, implement, and maintain various processes to improve the Bank's risk management of its loan portfolio, reduce adversely classified assets in accordance with certain timeframes, limit the extension of additional credit to borrowers with adversely classified loans subject to certain exceptions, adopt a written plan to properly monitor and reduce the Bank's commercial real estate concentration, continue to maintain the Bank's loan loss provision and review its adequacy at least quarterly, and formulate and implement a written plan to improve and maintain earnings to be forwarded for review by the Georgia Department and FDIC. The Bank is also required to obtain approval before any cash dividends can be paid.

The Bank has also agreed to have and maintain minimum capital ratios at specified levels higher than those otherwise required by applicable regulations as follows: Tier 1 leverage capital to total assets of 8% and total risk-based capital to total risk-weighted assets of 10%. At December 31, 2013, the Bank's capital ratios were 10.72% and 17.29%, respectively.

The MOU was lifted by regulatory agencies effective October 1, 2013 and replaced with a Board Resolution to ensure that the Bank's overall condition remains satisfactory.



Market Makers For Colony Bankcorp, Inc.  
Common Stock  
Sterne, Agee & Leach, Inc.  
Sam Haskell, Vice President  
Birmingham, Alabama  
866-378-3763

Raymond James & Associates, Inc.  
Jeff Snower, Vice President  
Chicago, Illinois  
312-655-2990

Fig-Partners, LLC  
Eric Lawless, Vice President  
Atlanta, Georgia  
866-344-2657

Colony Bankcorp, Inc. common stock is quoted on the NASDAQ Global Market under the symbol "CBAN."

## COLONY BANKCORP, INC. SHAREHOLDER INFORMATION

### CORPORATE HEADQUARTERS:

Colony Bankcorp, Inc.  
P.O. Box 989  
115 South Grant Street  
Fitzgerald, Georgia 31750  
229-426-6000

### ANNUAL MEETING

Tuesday, May 27, 2014 at 2:00 p.m.  
Colony Bankcorp, Inc.  
115 South Grant Street  
Fitzgerald, Georgia 31750

### INDEPENDENT AUDITORS:

McNair, McLemore, Middlebrooks & Co., LLC  
P.O. Box One  
Macon, Georgia 31202

### SHAREHOLDER SERVICES:

Shareholders who want to change the name, address or ownership of stock; to report lost, stolen or destroyed certificates; or to consolidate accounts should contact:

American Stock Transfer & Trust Company  
Shareholder Services  
59 Maiden Lane, Plaza Level  
New York, New York 10038  
800-937-5449

Photos above are actual clips from our recent commercial.





Colony Bankcorp, Inc.  
P.O. Box 989 • 115 S. Grant St.  
Fitzgerald, GA 31750  
229-426-6000 • [www.colonybank.com](http://www.colonybank.com)