COLONY BANKCORP INC
Form 10-K
March 12, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

x ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (Fee Required)
For the Fiscal Year Ended December 31, 2012

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (No Fee Required)
For the Transition Period from _____________to ______________

Commission File Number 000-12436

COLONY BANKCORP, INC.
(Exact Name of Registrant Specified in its Charter)

Georgia (State or Other Jurisdiction of Incorporation or Organization)	58-1492391 (I.R.S. Employer Identification Number)
115 South Grant Street Fitzgerald, Georgia (Address of Principal Executive Offices)	31750 (Zip Code)

(229) 426-6000
Issuer's Telephone Number, Including Area Code

Securities Registered Pursuant to Section 12(b) of the Act: None.

Securities Registered Pursuant to Section 12(g) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, Par Value $1.00	The NASDAQ Stock Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large Accelerated Filer o	Accelerated Filer o
Nonaccelerated Filer o (Do not check if a smaller reporting company)	Smaller Reporting Company x

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

State the aggregate market value of the voting and non-voting common equity held by nonaffiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked prices of such common equity, as of June 30, 2012: $28,778,233 based on stock price of $4.73.

Indicate the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date: 8,439,258 shares of $1.00 par value common stock as of March 12, 2013.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the information required by Part III of this Annual Report are incorporated by reference from the Registrant's definitive Proxy Statement for the 2012 annual meeting of shareholders to be filed with Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report.

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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 simi 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.

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Forward-Looking Statements and Factors that Could Affect Future Results (Continued)

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

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

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

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

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

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

Restrictions or conditions imposed by our regulators on our operations, including the terms of our memorandum of understanding.

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

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

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Part I
Item 1

Business

COLONY BANKCORP, INC.

General

Colony Bankcorp, Inc. (the “Company” or “Colony”) is a Georgia business corporation which was incorporated on November 8, 1982. The Company was organized for the purpose of operating as a bank holding company under the Federal Bank Holding Company Act of 1956, as amended, and the bank holding company laws of Georgia (Georgia Laws 1976, p. 168, et. seq.). On July 22, 1983, the Company, after obtaining the requisite regulatory approvals, acquired 100 percent of the issued and outstanding common stock of Colony Bank (formerly Colony Bank of Fitzgerald and The Bank of Fitzgerald), Fitzgerald, Georgia, through the merger of the Bank with a subsidiary of the Company which was created for the purpose of organizing the Bank into a one-bank holding company. Since that time, Colony Bank has operated as a wholly-owned subsidiary of the Company. Our business is conducted primarily through our wholly-owned subsidiary, which provides a broad range of banking services to its retail and commercial customers. The company headquarters are located at 115 South Grant Street, Fitzgerald, Georgia 31750, its telephone number is 229-426-6000 and its Internet address is http://www.colonybank.com. We operate twenty-eight domestic banking offices and one corporate operations office and, at December 31, 2012, we had approximately $1.14 billion in total assets, $734.08 million in total loans, $979.68 million in total deposits and $95.76 million in stockholder’s equity. Deposits are insured, up to applicable limits, by the Federal Deposit Insurance Corporation.

The Parent Company

Because Colony Bankcorp, Inc. is a bank holding company, its principal operations are conducted through its subsidiary bank, Colony Bank (the “Bank”). It has 100 percent ownership of its subsidiary and maintains systems of financial, operational and administrative controls that permit centralized evaluation of the operations of the subsidiary bank in selected functional areas including operations, accounting, marketing, investment management, purchasing, human resources, computer services, auditing, compliance and credit review. As a bank holding company, we perform certain stockholder and investor relations functions.

Colony Bank - Banking Services

Our principal subsidiary is the Bank. The Bank, headquartered in Fitzgerald, Georgia, offers traditional banking products and services to commercial and consumer customers in our markets. Our product line includes, among other things, loans to small and medium-sized businesses, residential and commercial construction and land development loans, commercial real estate loans, commercial loans, agri-business and production loans, residential mortgage loans, home equity loans, consumer loans and a variety of demand, savings and time deposit products. We also offer internet banking services, electronic bill payment services, safe deposit box rentals, telephone banking, credit and debit card services, remote depository products and access to a network of ATMs to our customers. Colony Bank conducts a general full service commercial, consumer and mortgage banking business through twenty-nine offices located in central, south and coastal Georgia cities of Fitzgerald, Warner Robins, Centerville, Ashburn, Leesburg, Cordele, Albany, Thomaston, Columbus, Sylvester, Tifton, Moultrie, Douglas, Broxton, Savannah, Eastman, Chester, Soperton, Rochelle, Pitts, Quitman and Valdosta, Georgia.

For additional discussion of our loan portfolio and deposit accounts, see “Management’s Discussion of Financial Condition and Results of Operations - Loans and Deposits.”

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Subordinated Debentures (Trust Preferred Securities)

During the second quarter of 2004, the Company formed Colony Bankcorp Statutory Trust III for the sole purpose of issuing $4,500,000 in Trust Preferred Securities through a pool sponsored by FTN Financial Capital Market. The securities have a maturity of thirty years and are redeemable after five years with certain exceptions.

During the second quarter of 2006, the Company formed Colony Bankcorp Capital Trust I for the sole purpose of issuing $5,000,000 in Trust Preferred Securities through a pool sponsored by SunTrust Bank Capital Markets. The securities have a maturity of thirty years and are redeemable after five years with certain exceptions.

During the first quarter of 2007, the Company formed Colony Bankcorp Capital Trust II for the sole purpose of issuing $9,000,000 in Trust Preferred Securities through a pool sponsored by Trapeza Capital Management, LLC. The securities have a maturity of thirty years and are redeemable after five years with certain exceptions. Proceeds from this issuance were used to pay off trust preferred securities issued on March 26, 2002 through Colony Bankcorp Statutory Trust I.

During the third quarter of 2007, the Company formed Colony Bankcorp Capital Trust III for the sole purpose of issuing $5,000,000 in Trust Preferred Securities through a pool sponsored by Trapeza Capital Management, LLC. The securities have a maturity of thirty years and are redeemable after five years with certain exceptions. Proceeds from this issuance were used to pay off trust preferred securities issued on December 19, 2002 through Colony Bankcorp Statutory Trust II.

Corporate Restructuring and Business Combinations

On April 30, 1984, after acquiring the requisite regulatory approvals, the Company acquired 100 percent of the issued and outstanding stock of Colony Bank Wilcox (formerly Community Bank of Wilcox and Pitts Banking Company), Pitts, Wilcox County, Georgia. As part of the transaction, Colony issued an additional 17,872 shares of its $10.00 par value common stock, all of which was exchanged with the holders of shares of common stock of Pitts Banking Company for 100 percent of the 250 issued and outstanding shares of common stock of Pitts Banking Company. Since the date of acquisition, Colony Bank Wilcox operated as a wholly-owned subsidiary of the Company until it was merged into Colony Bank effective August 1, 2008.

On November 1, 1984, after obtaining the requisite regulatory approvals, the Company acquired 100 percent of the issued and outstanding common stock of Colony Bank Ashburn (formerly Ashburn Bank), Ashburn, Turner County, Georgia, for a combination of cash and interest-bearing promissory notes. Since the date of acquisition, Colony Bank Ashburn operated as a wholly-owned subsidiary of the Company until it was merged into Colony Bank effective August 1, 2008.

On September 30, 1985, after obtaining the requisite regulatory approvals, the Company acquired 100 percent of the issued and outstanding common stock of Colony Bank of Dodge County, (formerly The Bank of Dodge County), Chester, Dodge County, Georgia. The stock was acquired in exchange for the issuance of 3,500 shares of common stock of Colony. Since the date of acquisition, Colony Bank of Dodge County operated as a wholly-owned subsidiary of the Company until it was merged into Colony Bank effective August 1, 2008.

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On July 31, 1991, after obtaining the requisite regulatory approvals, the Company acquired 100 percent of the issued and outstanding common stock of Colony Bank Worth, (formerly Worth Federal Savings and Loan Association and Bank of Worth), Sylvester, Worth County, Georgia. The stock was acquired in exchange for cash and the issuance of 7,661 shares of common stock of Colony for an aggregate purchase price of approximately $718,000. Since the date of acquisition, Colony Bank Worth operated as a wholly-owned subsidiary of the Company until it was merged into Colony Bank effective August 1, 2008.

On November 8, 1996, Colony organized Colony Management Services, Inc. to provide support services to each subsidiary. Services provided include loan and compliance review, internal audit and data processing. Colony Management Services, Inc. operated as a wholly-owned subsidiary of the Company until it was merged into Colony Bank effective August 1, 2008.

On November 30, 1996, after obtaining the requisite regulatory approvals, the Company acquired 100 percent of the issued and outstanding common stock of Colony Bank Southeast (formerly Broxton State Bank), Broxton, Coffee County, Georgia in a business combination accounted for as a pooling of interests. Broxton State Bank became a wholly-owned subsidiary of the Company through the exchange of 157,735 shares of the Company’s common stock for all of the outstanding stock of Broxton State Bank. Since the date of acquisition, Colony Bank Southeast operated as a wholly-owned subsidiary of the Company until it was merged into Colony Bank effective August 1, 2008.

On March 2, 2000, Colony Bank Ashburn purchased the capital stock of Colony Mortgage Corp (formerly Georgia First Mortgage Company) in a business combination accounted for as a purchase. The purchase price of $346,725 was the fair value of the net assets of Georgia First Mortgage Company at the date of purchase. Colony Mortgage Corp is primarily engaged in residential real estate mortgage lending in the state of Georgia. Colony Mortgage Corp operated as a subsidiary of Colony Bank effective with the August 1, 2008 merger until October 1, 2012 when the corporation was dissolved.

On March 29, 2002, after obtaining the requisite regulatory approvals, the Company acquired 100 percent of the issued and outstanding stock of Colony Bank Quitman, FSB, (formerly Quitman Federal Saving Bank), Quitman, Brooks County, Georgia. Quitman Federal Savings Bank became a wholly-owned subsidiary of the Company through the exchange of 367,093 shares of the Company’s common stock and cash for an aggregate acquisition price of $7,446,163. Since the date of acquisition, Colony Bank Quitman, FSB operated as a wholly-owned subsidiary of the Company until it was merged into Colony Bank effective August 1, 2008.

On March 19, 2004, Colony Bank Ashburn purchased Flag Bank - Thomaston office in a business combination accounted for as a purchase. Since the date of acquisition, the Thomaston office operated as an office of Colony Bank Ashburn until August 1, 2008 when it became an office of Colony Bank.

On August 1, 2008, the Company effected a merger of its seven banking subsidiaries and its one nonbank subsidiary into one surviving bank subsidiary, Colony Bank (formerly Colony Bank of Fitzgerald).

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Markets and Competition

The banking industry in general is highly competitive. Our market areas of central, south and coastal Georgia have experienced good economic and population growth the past several years, however the current downturn in the housing and real estate market that began in late 2007 along with recessionary fears has proven to be quite challenging - not only for Colony but the entire banking industry. In our markets, we face competitive pressures in attracting deposits and making loans from larger regional banks and smaller community banks, thrift institutions, credit unions, consumer finance companies, mortgage bankers, brokerage firms and insurance companies. The principal factors in competing for deposits and loans include interest rates, fee structures, range of products and services offered and convenience of office and ATM locations. The banking industry is also experiencing increased competition for deposits from less traditional sources such as money market and mutual funds. In addition, intense market demands, economic concerns, volatile interest rates and customer awareness of product and services have forced banks to be more competitive - often resulting in margin compression and a decrease in operating efficiency.

In response to competitive issues, the Company merged all of its operations into one operating subsidiary, Colony Bank, effective August 1, 2008. This consolidation effort enabled the Company to align products, pricing and marketing efforts while re-allocating resources to support management's future growth strategies.

Correspondents

Colony Bank has correspondent relationships with the following banks: Federal Reserve Bank in Atlanta, Georgia; SunTrust Bank in Atlanta, Georgia; FTN Financial in Memphis, Tennessee, CenterState Bank in Lake Wales, Florida and Federal Home Loan Bank in Atlanta, Georgia. The correspondent relationships facilitate the transactions of business by means of loans, collections, investment services, lines of credit and exchange services. As compensation for these services, the Bank maintains balances with its correspondents in noninterest-bearing accounts and pays some service charges.

Employees

On December 31, 2012, the Company had a total of 308 full-time and 19 part-time employees. We consider our relationship with our employees to be satisfactory.

The Company has a noncontributory profit-sharing plan covering all employees subject to certain minimum age and service requirements. No Company contributions were made in 2012 due to performance. In addition, the Company maintains a comprehensive employee benefit program providing, among other benefits, hospitalization, major medical, life insurance and disability insurance. Management considers these benefits to be competitive with those offered by other financial institutions in our market area. Colony's employees are not represented by any collective bargaining group.

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SUPERVISION AND REGULATION
BANK HOLDING COMPANY REGULATION

General

Colony is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (BHCA). We are extensively regulated under federal and state law. Generally, these laws and regulations are intended to protect our depositors, not necessarily our shareholders or our creditors. As a bank holding company registered with the Federal Reserve under the BHCA and the Georgia Department of Banking and Finance ("the Georgia Department") under the Financial Institutions Code of Georgia, we are subject to supervision, examination and reporting by the Federal Reserve and the Georgia Department. Our activities are limited to banking, managing or controlling banks, furnishing services to or performing services for its subsidiaries, or engaging in any other activity that the Federal Reserve determines to be so closely related to banking, or managing or controlling banks, as to be a proper incident to these activities.

Colony is required to file with the Federal Reserve and the Georgia Department periodic reports and any additional information as they may require. The Federal Reserve and Georgia Department will also regularly examine the Company. The Federal Deposit Insurance Corporation ("FDIC") and Georgia Department also examine the Bank.

The following is a summary of certain provisions of certain laws that affect the regulation of bank holding companies and banks. The discussion is qualified in its entirety by reference to applicable laws and regulations. Changes in such laws and regulations may have a material effect on our business and prospects.

Activity Limitations

The BHCA requires prior Federal Reserve approval for, among other things:

the acquisition by a bank holding company of direct or indirect ownership or control of more than 5 percent of the voting shares or substantially all of the assets of any bank, or

a merger or consolidation of a bank holding company with another bank holding company.

Similar requirements are imposed by the Georgia Department.

A bank holding company may acquire direct or indirect ownership or control of voting shares of any company that is engaged directly or indirectly in banking, or managing or controlling banks, or performing services for its authorized subsidiaries. A bank holding company may also engage in or acquire an interest in a company that engages in activities that the Federal Reserve has determined by regulation or order to be so closely related to banking as to be a proper incident to these activities. The Federal Reserve normally requires some form of notice or application to engage in or acquire companies engaged in such activities. Under the BHCA, Colony will generally be prohibited from engaging in or acquiring direct or indirect control of more than 5 percent of the voting shares of any company engaged in activities other than those referred to above.

The BHCA permits a bank holding company located in one state to lawfully acquire a bank located in any other state, subject to deposit percentage, aging requirements and other restrictions. The Riegle-Neal Interstate Banking and Branching Efficiency Act also generally provides that national and state chartered banks may, subject to applicable state law, branch interstate through acquisitions of banks in other states.

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In November 1999, Congress enacted the Gramm-Leach-Bliley Act, which made substantial revisions to the statutory restrictions separating banking activities from other financial activities. Under the Gramm-Leach-Bliley Act, bank holding companies that are well capitalized, well managed and meet other conditions can elect to become “financial holding companies.” As financial holding companies, they and their subsidiaries are permitted to acquire or engage in activities that were not previously allowed bank holding companies, such as insurance underwriting, securities underwriting and distribution, travel agency activities, broad insurance agency activities, merchant banking and other activities that the Federal Reserve determines to be financial in nature or complementary to these activities. Financial holding companies continue to be subject to the overall oversight and supervision of the Federal Reserve, but the Gramm-Leach-Bliley Act applies the concept of functional regulation to the activities conducted by subsidiaries. For example, insurance activities would be subject to supervision and regulation by state insurance authorities. While Colony has not elected to become a financial holding company in order to exercise the broader activity powers provided by the Gramm-Leach-Bliley Act, it may elect to do so in the future.

Limitations on Acquisitions of Bank Holding Companies

As a general proposition, other companies seeking to acquire control of a bank holding company would require the approval of the Federal Reserve under the BHCA. In addition, individuals or groups of individuals seeking to acquire control of a bank holding company would need to file a prior notice with the Federal Reserve (which the Federal Reserve may disapprove under certain circumstances) under the Change in Bank Control Act. Control is conclusively presumed to exist if an individual or company acquires 25 percent or more of any class of voting securities of the bank holding company. Control may exist under the Change in Bank Control Act if the individual or company acquires 10 percent or more of any class of voting securities of the bank holding company.

Source of Strength Doctrine

In accordance with Federal Reserve Board policy, the holding company is expected to act as a source of financial and managerial strength to the Bank. Under this policy, the holding company is expected to commit resources to support its bank subsidiary, including at times when the holding company may not be in a financial position to provide it. As discussed below, the holding company could be required to guarantee the capital plan of the Bank if it becomes undercapitalized for purposes of banking regulations. Any capital loans by a bank holding company to its subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. The BHC Act provides that, in the event of a bank holding company’s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a bank subsidiary will be assumed by the bankruptcy trustee and entitled to priority of payment.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) has added additional guidance regarding the source of strength doctrine and has directed the regulatory agencies to promulgate new regulations to increase the capital requirements for bank holding companies to a level that matches those of banking institutions.

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Sale of TARP Securities

On January 9, 2009, the Company, pursuant to the TARP CPP, issued and sold to the Treasury, for an aggregate cash purchase price of $28 million, (i) 28,000 shares (the “Preferred Shares”) of the Company’s Fixed Rate Cumulative Perpetual Preferred Stock, Series A, having a liquidation preference of $1,000 per share, and (ii) a ten-year warrant (the “Warrant”) to purchase up to 500,000 shares of our common stock, par value $1.00 per share, at an exercise price of $8.40 per share. On January 29, 2013, the Company’s 28,000 shares of Cumulative Perpetual Preferred Stock, Series A (the Preferred Stock) was sold by the Treasury to the public through a modified dutch auction. This auction is part of the Treasury’s ongoing efforts to wind down its remaining TARP bank investments. The sale of the Preferred Stock to new investors did not result in any accounting entries and does not change the Company’s capital position. The Treasury continues to hold the Warrant for 500,000 shares of common stock; however, the Company has notified the Treasury of its intentions to repurchase the warrant, although no price for the repurchase has been set.

Cumulative dividends on the Preferred Shares will continue to accrue at a rate of 5 percent per annum for the first five years from initial issuance and at a rate of 9 percent per annum thereafter. The Preferred Stock continues to have no maturity date and ranks senior to the Company’s Common Stock. The Preferred Stock continues to be redeemable at the option of the Company at 100 percent of their liquidation preference, plus any accrued and unpaid dividends.

The Dodd-Frank Act

The Dodd-Frank Act, which was enacted on July 21, 2010, significantly changed the current bank regulatory structure and affected the lending, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires the Federal Reserve Board to set minimum capital levels for bank holding companies that are as stringent as those required for insured depository institutions, and the components of Tier 1 capital would be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. In addition, the proceeds of trust preferred securities are excluded from Tier 1 capital unless such securities were issued before May 19, 2010 by bank or savings and loan holding companies with less than $15 billion of assets. The legislation also establishes a floor for capital of insured depository institutions that cannot be lower than the standards in effect today, and directs the federal banking regulators to implement new leverage and capital requirements within 18 months. These new leverage and capital requirements must take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives.

The Dodd-Frank Act also created a new Consumer Financial Protection Bureau, which has been delegated broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rulemaking authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10.0 billion in assets. Banks and savings institutions with $10.0 billion or less in assets will be examined by their applicable bank regulators. The new legislation also weakens the federal preemption available for national banks and federal savings associations, and gives the state attorneys general the ability to enforce applicable federal consumer protection laws.

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The Dodd-Frank Act (Continued)

The Dodd-Frank Act increased stockholder influence over boards of directors by requiring companies to give stockholders a nonbinding vote on executive compensation and so-called "golden parachute" payments, and by authorizing the Securities and Exchange Commission to promulgate rules that would allow stockholders to nominate and solicit votes for their own candidates using a company's proxy materials. The legislation also directed the Federal Reserve Board to promulgate rules prohibiting excessive incentive compensation paid to bank holding company executives, regardless of whether the company is publicly traded.

The Dodd-Frank Act contains a wide variety of provisions (many of which are not yet effective) affecting the regulation of depository institutions in addition to those stated above. Those include restrictions related to mortgage originations, risk retention requirements as to securitized loans and the Consumer Financial Protection Bureau. The full effect of the Dodd-Frank Act on our business and operations will not be known for years until regulations implementing the statute are written and adopted. The Dodd-Frank Act may have a material effect on the Company's and the Bank's operations, particularly through increased compliance costs resulting from possible future consumer and fair lending regulations.

Limitations on Senior Executive Compensation

In June of 2010, federal banking regulators issued guidance designed to help ensure that incentive compensation policies at banking organizations do not encourage excessive risk-taking or undermined the safety and soundness of the organization. In connection with this guidance, the regulatory agencies announced that they will review incentive compensation arrangements as part of the regular, risk-focused supervisory process. Regulatory authorities may also take enforcement action against a banking organization if its incentive compensation arrangement or related risk management, control, or governance processes pose a risk to the safety and soundness of the organization and the organization is not taking prompt and effective measures to correct the deficiencies. To ensure that incentive compensation arrangements do not undermine safety and soundness at insured depository institutions, the incentive compensation guidance sets forth the following key principles:

Incentive compensation arrangements should provide employees incentives that appropriately balance risk and financial results in a manner that does not encourage employees to expose the organization to imprudent risk;

Incentive compensation arrangements should be compatible with effective controls and risk management; and

Incentive compensation arrangements should be supported by strong corporate governance, including active and effective oversight by the board of directors.

Tying

Bank holding companies and their affiliates are prohibited from tying the provision of certain services, such as extending credit, to other services or products offered by the holding company or its affiliates, such as deposit products.

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Capital; Dividends; Source of Strength

The Federal Reserve imposes certain capital requirements on bank holding companies under the Bank Holding Company Act, including a minimum leverage ratio and a minimum ratio of “qualifying” capital to risk-weighted assets. These requirements are described below under “Capital Regulations.” Subject to its capital requirements and certain other restrictions, we are able to borrow money to make a capital contribution to Colony Bank, and such loans may be repaid from dividends paid from Colony Bank to us.

The ability of Colony Bank to pay dividends, however, will be subject to regulatory restrictions that are described below under “Dividends.” We are also able to raise capital for contributions to Colony Bank by issuing securities without having to receive regulatory approval, subject to compliance with federal and state securities laws.

In accordance with Federal Reserve policy, which has been codified by the Dodd-Frank Act, we are expected to act as a source of financial strength to Colony Bank and to commit resources to support Colony Bank in circumstances in which we might not otherwise do so. In furtherance of this policy, the Federal Reserve may require a financial holding company to terminate any activity or relinquish control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) upon the Federal Reserve's determination that such activity or control constitutes a serious risk to the financial soundness or stability of any subsidiary depository institution of the bank holding company. Further, federal bank regulatory authorities have additional discretion to require a financial holding company to divest itself of any bank or nonbank subsidiary if the agency determines that divestiture may aid the depository institution's financial condition.

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BANK REGULATION

General

The Bank is a commercial bank chartered under the laws of the State of Georgia, and as such is subject to supervision, regulation and examination by the Georgia Department. The Bank is a member of the FDIC, and their deposits are insured by the FDIC's Deposit Insurance Fund up to the amount permitted by law. The FDIC and the Georgia Department routinely examine the Bank and monitor and regulate all of the Bank's operations, including such things as adequacy of reserves, quality and documentation of loans, payments of dividends, capital adequacy, adequacy of systems and controls, credit underwriting and asset liability management, compliance with laws and establishment of branches. Interest and other charges collected or contracted for by the Bank is subject to state usury laws and certain federal laws concerning interest rates. The Bank files periodic reports with the FDIC and the Georgia Department.

BUSINESS
Recent Developments

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. At December 31, 2012, the Bank is in compliance with terms of the MOU.

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 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 capital to total average assets of 8 percent and total risk-based capital to total risk-weighted assets of 10 percent. At December 31, 2012, the Bank's capital ratios were 10.31 percent and 16.61 percent, respectively.

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Transactions with Affiliates and Insiders

The Company is a legal entity separate and distinct from the Bank. Various legal limitations restrict the Bank from lending or otherwise supplying funds to the Company and other nonbank subsidiaries of the Company, all of which are deemed to be “affiliates” of the Bank for the purposes of these restrictions. The Company and the Bank are subject to Section 23A of the Federal Reserve Act. Section 23A defines “covered transactions,” which include extensions of credit, and limits a bank’s covered transactions with any affiliate to 10 percent of such bank’s capital and surplus and with all affiliates to 20 percent of such bank’s capital and surplus. All covered and exempt transactions between a bank and its affiliates must be on terms and conditions consistent with safe and sound banking practices, and banks and their subsidiaries are prohibited from purchasing low-quality assets from the bank’s affiliates. Finally, Section 23 A requires that all of a bank’s extensions of credit to an affiliate be appropriately secured by acceptable collateral, generally United States government or agency securities. The Company and the Bank are also subject to Section 23B of the Federal Reserve Act, which generally limits covered and other transactions between a bank and its affiliates to terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the bank as prevailing at the time for transactions with unaffiliated companies. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) enhances the requirements for certain transactions with affiliates under Section 23A and 23B, including an expansion of the definition of “covered transactions” and increasing the amount of time for which collateral requirements regarding covered transactions must be maintained. The Bank is also subject to restrictions on extensions of credit to its executive officers, directors, principal shareholders and their related interests. These extensions of credit (1) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (2) must not involve more than the normal risk of repayment or present other unfavorable features. Effective July 21, 2011, an insured depository institution is prohibited from engaging in asset purchases or sales transactions with its officers, directors or principal shareholders unless on market terms and, if the transaction represents greater than 10 percent of the capital and surplus of the bank, it has been approved by a majority of the disinterested directors.

Dividends

The Company is a legal entity separate and distinct from the Bank. The principal source of the Company’s cash flow, including cash flow to pay dividends to its stockholders, is dividends that the Bank pays to it. Statutory and regulatory limitations apply to the Bank’s payment of dividends to the Company as well as to the Company’s payment of dividends to its stockholders. Pursuant to MOU entered into with the Georgia Department and the FDIC, the Bank is required to obtain approval from these regulators before any cash dividends can be paid. Currently, the Company is likewise unable to declare or pay any cash dividend to its shareholders or to pay interest on its junior subordinated debentures without first obtaining prior written consent from the applicable regulators.

As of December 31, 2012, the Company has obtained approval from its regulators to declare and pay scheduled dividend payments on its equity securities and interest on its junior subordinated debentures in each instance where it has sought such approval, except for the requests to pay (i) the dividend payment on the TARP preferred stock due on February 15, 2012 and (ii) the interest payments on its four series of junior subordinated debentures due on March 19, 2012, March 30, 2012, April 2, 2012 and April 30, 2012, respectively, all of which were denied by the regulators because of a lack of funds at the Company to make such payments. Since such time, the Company has not sought, and for the foreseeable future does not expect to seek, regulatory approval to pay a dividend on the Securities or interest on its junior subordinated debentures because it does not reasonably believe that such approval would be granted by the regulators.

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Item 1 (Continued)

As of December 31, 2012, the Bank has twice sought regulatory approval to declare and pay a cash dividend to the Company. On one occasion, in the first quarter of 2012, the Bank's request was denied. On the second occasion, in the fourth quarter of 2012, the Bank's request was approved. The Bank will therefore declare and pay a cash dividend to the Company in the first quarter of 2013. Such regulatory approval provided that the Company may not use the dividend proceeds to pay dividends on its equity securities or to make interest payments on its junior subordinated debentures.

The Company expects that it will use the dividend proceeds for general corporate purposes. The Bank expects to request regulatory approval to pay dividends to the Company in the future, but cannot give any assurances that such future requests will receive approval or whether such approvals will contain similar restrictions that the proceeds therefrom may not be used to pay dividends on the Company's equity securities or interest on its junior subordinated debentures.

Furthermore, while the Company is deferring interest payments on its junior subordinated debentures, the Company may not declare or pay any dividends on any of its capital stock. For the foreseeable future after December 31, 2012, the Company expects to be unable to declare and pay any scheduled interest payments on its junior subordinated debentures.

The Company has not paid scheduled dividend payments on the TARP preferred stock since the payment due on November 15, 2011, and for the foreseeable future reasonably expects to be unable to declare and pay any scheduled dividend payments on the TARP preferred stock.

A variety of federal and state laws and regulations affect the ability of the Bank and the Company to pay dividends. A depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. The federal banking agencies may prevent the payment of a dividend if they determine that the payment would be an unsafe and unsound banking practice. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings. In addition, regulations promulgated by the Georgia Department limit the Bank's payment of dividends.

Enforcement Policies and Actions

Federal law gives the Federal Reserve and FDIC substantial powers to enforce compliance with laws, rules and regulations. Bank or individuals may be ordered to cease and desist from violations of law or other unsafe or unsound practices. The agencies have the power to impose civil money penalties against individuals or institutions of up to $1,000,000 per day for certain egregious violations. Persons who are affiliated with depository institutions can be removed from any office held in that institution and banned from participating in the affairs of any financial institution. The banking regulators have not hesitated to use the enforcement authorities provided in federal law.

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Item 1 (Continued)

Capital Regulations

The federal bank regulatory authorities have adopted capital guidelines for banks and bank holding companies. In general, the authorities measure the amount of capital an institution holds against its assets. There are three major capital tests: (i) the Total Capital ratio (the total of Tier 1 Capital and Tier 2 Capital measured against risk-adjusted assets), (ii) the Tier 1 Capital ratio (Tier 1 Capital measured against risk-adjusted assets) and (iii) the leverage ratio (Tier 1 Capital measured against average (i.e., nonrisk-weighted) assets).

Tier 1 Capital consists of common equity, retained earnings and a limited amount of qualifying preferred stock, less disallowed deferred tax assets, goodwill and core deposit intangibles. Tier 2 Capital consists of nonqualifying preferred stock, qualifying subordinated, perpetual and/or mandatory convertible debt, term subordinated debt and intermediate term preferred stock and up to 45 percent of the pretax unrealized holding gains on available-for-sale equity securities with readily determinable market values that are prudently valued, and a limited amount of any loan loss allowance.

In measuring the adequacy of capital, assets are generally weighted for risk. Certain assets, such as cash and U.S. government securities, have a zero risk weighting. Others, such as commercial and consumer loans, have a 100 percent risk weighting. Risk weightings are also assigned for off-balance sheet items such as loan commitments. The various assets are multiplied by the appropriate risk-weighting to determine risk-adjusted assets for the capital calculations. For the leverage ratio mentioned above, average assets are not risk-weighted.

The federal banking agencies must take “prompt corrective action” in respect of depository institutions that do not meet minimum capital requirements. There are five tiers for financial institutions: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized.” Under these regulations, a bank will be:

“well capitalized” if it has a Total Capital ratio of 10 percent or greater, a Tier 1 Capital ratio of 6 percent or greater, a leverage ratio of 5 percent or better - or 4 percent in certain circumstances - and is not subject to any written agreement, order, capital directive, or prompt corrective action directive by a federal bank regulatory agency to meet and maintain a specific capital level for any capital measure;

“adequately capitalized” if it has a Total Capital ratio of 8 percent or greater, a Tier 1 Capital ratio of 4 percent or greater, and a leverage ratio of 4 percent or greater - or 3 percent in certain circumstances - and is not well capitalized;

“undercapitalized” if it has a Total Capital ratio of less that 8 percent, a Tier 1 Capital ratio of less that 4 percent - or 3 percent in certain circumstances;

“significantly undercapitalized” if it has a Total Capital ratio of less than 6 percent or a Tier 1 Capital ratio of less than 3 percent, or a leverage ratio of less than 3 percent; or

“critically undercapitalized” if its tangible equity is equal to or less than 2 percent of average quarterly assets.

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Part I (Continued)
Item 1 (Continued)

Capital Regulations (Continued)

Federal law generally prohibits a depository institution from making any capital distribution, including the payment of a dividend or paying any management fee to its holding company if the depository institution would be undercapitalized as a result. Undercapitalized depository institutions may not accept brokered deposits absent a waiver from the FDIC, are subject to growth limitations and are required to submit a capital restoration plan for approval. For a capital restoration plan to be acceptable, the depository institution’s parent holding company must guarantee that the institution will comply with such capital restoration plan. The aggregate liability of the parent holding company is limited to the lesser of 5 percent of the depository institution’s total assets at the time it became undercapitalized, and the amount necessary to bring the institution into compliance with applicable capital standards. If a depository institution fails to submit an acceptable plan, it is treated as if it is significantly undercapitalized. If the controlling holding company fails to fulfill its obligations under this law and files, or has filed against it, a petition under the federal Bankruptcy Code, the FDIC claim related to the holding company’s obligations would be entitled to a priority in such bankruptcy proceeding over third party creditors of the bank holding company.

Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. Critically undercapitalized institutions are subject to the appointment of a receiver or conservator.

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At December 31, 2012, the Company exceeded the minimum Tier 1, risk-based and leverage ratios and qualified as "well capitalized" under current Federal Reserve Board criteria. The following table sets forth certain capital information for the Company as of December 31, 2012. As of December 31, 2012, Colony had Tier 1 Capital and Total Capital of approximately 15.22 percent and 16.47 percent, respectively, of risk-weighted assets. As of December 31, 2012, Colony had a leverage ratio of Tier 1 Capital to total average assets of approximately 10.22 percent.

	December 31, 2012		
	Amount	Percent	
Leverage Ratio			
Actual	$113,283	10.22	%
Well-Capitalized Requirement	55,428	5.00	
Minimum Required (1)(2)	44,343	4.00	
Risk Based Capital:			
Tier 1 Capital			
Actual	113,283	15.22	
Well-Capitalized Requirement	44,661	6.00	
Minimum Required (1)	29,774	4.00	
Total Capital			
Actual	122,630	16.47	
Well-Capitalized Requirement	74,436	10.00	
Minimum Required (1)(2)	59,548	8.00	

(1) Represents the minimum requirement. Institutions that are contemplating acquisitions or anticipating or experiencing significant growth may be required to maintain a substantially higher leverage ratio.
(2) As discussed in Note 21 of the consolidated financial statements as of December 31, 2012, the Bank has agreed to have and maintain a minimum Tier 1 Capital to average assets ratio of 8 percent and a minimum Total Capital to risk-weighted assets ratio of 10 percent as a result of the Bank's Memorandum of Understanding (MOU). Refer to Note 21.

The guidelines also provide that institutions experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Higher capital may be required in individual cases, depending upon a bank or bank holding company's risk profile. All bank holding companies and banks are expected to hold capital commensurate with the level and nature of their risks, including the volume and severity of their problem loans. Lastly, the Federal Reserve's guidelines indicate that the Federal Reserve will continue to consider a "Tangible Tier 1 Leverage Ratio," calculated by deducting all intangibles, in evaluating proposals for expansion or new activity.

On August 30, 2012, the federal banking agencies issued proposed rules that would implement the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act. "Basel III" refers to two consultative documents released by the Basel Committee on Banking Supervision in December 2009, the rules-text released in December 2010, and loss-absorbency rules issued in January 2011, which include significant changes to bank capital, leverage, and liquidity requirements. The proposed rules are subject to a comment period which ended on October 22, 2012.

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Item 1 (Continued)

The proposed rules include new risk-based capital and leverage ratios, which would be phased in from 2013 to 2019, and would revise the definition of what constitutes “capital” for purposes of calculating those ratios. The proposed new minimum capital level requirements applicable to the Company and the Bank under the proposals would be: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The proposed rules would also establish a “capital conservation buffer” of 2.5% above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital and would result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%; (ii) a Tier 1 capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement would be phased in beginning in January 2016 at 0.625% of risk-weighted assets and would increase by that amount each year until fully implemented in January 2019. An institution would be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations would establish a maximum percentage of eligible retained income that could be utilized for such actions.

FDIC Insurance Assessments

The Bank’s deposits are insured by the Deposit Insurance Fund (the “DIF”) of the FDIC up to the maximum amount permitted by law, which was permanently increased to $250,000 by the Dodd-Frank Act. The FDIC uses the DIF to protect against the loss of insured deposits if an FDIC-insured bank or savings association fails. Pursuant to the Dodd-Frank Act, the FDIC must take steps, as necessary, for the DIF reserve ratio to reach 1.35 percent of estimated insured deposits by September 30, 2020. The Bank is thus subject to FDIC deposit premium assessments.

Recent depository institutional failures have resulted in a decline in the targeted amount of funds in the DIF mandated by law. In 2009, the FDIC undertook several measures in an effort to replenish the DIF. It imposed a 5 basis point emergency assessment on insured depository institutions that was paid on September 30, 2009. In the fourth quarter of 2009, the FDIC adopted a rule that, in lieu of any further special assessment in 2009, required all insured depository institutions, with limited exceptions, to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012. The prepaid assessments were to be applied against future quarterly assessments until the prepaid assessment is exhausted or the balance is returned, whichever occurs first. This assessment totaled $6.3 million for the Bank. At December 31, 2012, the remainder of the prepaid assessment available to be applied toward future assessments totaled $1.36 million and is included in Other Assets on the Company’s consolidated balance sheet.

On April 1, 2011, new regulations became effective which redefined the assessment base used for calculating deposit insurance assessments. Rather than the previous system, whereby the deposit insurance assessment was calculated using an institution’s total domestic deposits, less a few allowable exclusions, the new assessment base is calculated using average total assets of the institution minus average tangible equity (Tier 1 Capital). The FDIC continues to utilize a risk-based assessment system in which institutions will be subject to assessment rates ranging from 2.5 to 45 basis points, subject to adjustments for unsecured debt and, in certain cases, brokered deposits.

In October 2010, the FDIC adopted a new DIF restoration plan to ensure that the fund reserve ratio reaches 1.35 percent by September 30, 2020, as required by the Dodd-Frank Act. At least semi-annually, the FDIC will update its loss and income projections for the fund and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking if required.

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Item 1 (Continued)

FDIC Insurance Assessments (Continued)

The FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

Community Reinvestment Act

The Bank is subject to the provisions of the Community Reinvestment Act of 1977, as amended (the CRA), and the federal banking agencies' related regulations. Under the CRA, all banks and thrifts have a continuing and affirmative obligation, consistent with safe and sound operation, to help meet the credit needs for their entire communities, including low- and moderate-income neighborhoods. The CRA requires a depository institution's primary federal regulator, in connection with its examination of the institution or its evaluation of certain regulatory applications, to assess the institution's record in assessing and meeting the credit needs of the community served by that institution, including low- and moderate-income neighborhoods. The regulatory agency's assessment of the institution's record is made available to the public.

Current CRA regulations rate institutions based on their actual performance in meeting community credit needs. The Bank received a "satisfactory" rating on its most recent examination in 2012.

Consumer Regulations

Interest and other charges collected or contracted for by the Bank is subject to state usury laws and certain federal laws concerning interest rates. The Bank's loan operations are also subject to federal laws and regulations applicable to credit transactions, such as those:

Governing disclosures of credit terms to consumer borrowers;

Requiring financial institutions provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

Prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

Governing the use and provision of information to credit reporting agencies; and

Governing the manner in which consumer debts may be collected by collection agencies.

The deposit operations of the Bank is also subject to laws and regulations that:

Impose a duty to maintain the confidentiality of consumer financial records and prescribe procedures for complying with administrative subpoenas of financial records; and

Govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

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Item 1 (Continued)

Fiscal and Monetary Policy

Banking is a business that depends on interest rate differentials. In general, the difference between the interest paid by a bank on its deposits and its other borrowings, and the interest received by a bank on its loans and securities holdings, constitutes the major portion of a bank's earnings. Thus, Colony's earnings and growth and that of the Bank will be subject to the influence of economic conditions, generally both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve. The Federal Reserve regulates the supply of money through various means, including open market dealings in United States government securities, the discount rate at which banks may borrow from the Federal Reserve and the reserve requirements on deposits.

The monetary policies of the Federal Reserve historically have had a significant effect on the operating results of commercial banks and mortgage banking operations and will continue to do so in the future. The Company cannot predict the conditions in the national and international economies and money markets, the actions and changes in policy by monetary and fiscal authorities or their effect on the Bank.

Financial Privacy

The federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. These regulations affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

Anti-Money Laundering and the USA Patriot Act

A major focus of governmental policy on financial institutions in recent years has been aimed at combating money laundering and terrorist financing. The USA PATRIOT Act of 2001 (the "USA Patriot Act") substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The United States Treasury Department has issued and, in some cases, proposed a number of regulations that apply various requirements of the USA Patriot Act to financial institutions such as the Bank. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers. Certain of those regulations impose specific due diligence requirements on financial institutions that maintain correspondent or private banking relationships with non-U.S. financial institutions or persons. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the Company.

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Part I (Continued)
Item 1 (Continued)

Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the “OFAC” rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control (“OFAC”). The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on “U.S. persons” engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

Legislative and Regulatory Initiatives

From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of the Company in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The Company cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on the financial condition or results of operations of the Company. A change in statutes, regulations or regulatory policies applicable to the Company or any of its subsidiaries could have a material effect on the business of the Company.

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Part I (Continued)

Item 1A

Risk Factors

Not Applicable.

Item 1B

Unresolved Staff Comments

Not Applicable.

Item 2

Properties

The principal properties of the Registrant consist of the properties of the Bank. The Bank owns all of the banking offices occupied except two offices in Tifton, one office in Valdosta, and one office in Douglas which are leased. In addition, the Company owns the corporate offices located in Fitzgerald, Georgia.

Item 3

Legal Proceedings

The Company and its subsidiary may become parties to various legal proceedings arising from the normal course of business. As of December 31, 2012, there are no material pending legal proceedings to which Colony or its subsidiary are a party or of which any of its property is the subject.

Item 4

Mine Safety Disclosures

Not Applicable.

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Part II
Item 5

Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities

Effective April 2, 1998, Colony Bankcorp, Inc. common stock is quoted on the NASDAQ Global Market under the symbol “CBAN.” Prior to this date, there was no public market for the common stock of the registrant.

The following table sets forth the high, low and close sale prices per share of the common stock as reported on the NASDAQ Global Market, and the dividends declared per share for the periods indicated.

Year Ended December 31, 2012	High	Low	Close
Fourth Quarter	$4.50	$3.42	$3.60
Third Quarter	5.48	3.22	3.68
Second Quarter	8.06	3.70	4.73
First Quarter	5.83	1.90	3.75
Year Ended December 31, 2011			
Fourth Quarter	2.79	1.99	2.24
Third Quarter	3.48	2.40	2.63
Second Quarter	4.24	2.72	2.87
First Quarter	4.50	4.01	4.15

No cash dividends were paid on its common stock in 2011 or 2012. The Company’s board of directors suspended the payment of dividends in the third quarter of 2009. For a description of the restrictions and limitations on the Company’s ability to pay dividends, please see “Dividends” on Page 18.

As of December 31, 2012, the Company had approximately 1,960 common stockholders of record. At December 31, 2012, the U.S. Treasury held all 28,000 shares of the Company’s Fixed Rate Cumulative Perpetual Preferred Stock, Series A.

On March 30, 2010, Colony Bankcorp, Inc. accepted the subscriptions of several investors in a private placement offering to accredited investors under an exemption from registration contained in Section 4(2) of the Securities Act of 1933 and Rule 506 of Regulation D under the Securities Act. The Company offered a maximum of 1,216,545 shares of its common stock at a price of $4.11-$4.50 per share. The price for non-affiliates was determined using a twenty day average trading price as quoted on NASDAQ Stock Market immediately prior to the beginning of the offering. All of the shares were purchased for a total of $5.08 million, less offering expenses of approximately $20,000. The offering was closed March 30, 2010.

Issuer Purchase of Equity Securities

The Company purchased no shares of the Company’s common stock during the quarter ended December 31, 2012.

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Part II (Continued)
Item 6

Selected Financial Data

	Year Ended December 31,				
	2012	2011	2010	2009	2008
	(Dollars in Thousands, except per share data)				
Selected Balance Sheet Data					
Total Assets	$1,139,397	$1,195,376	$1,275,658	$1,307,089	$1,252,782
Total Loans, Net of Unearned Interest and Fees	746,816	716,264	813,189	931,252	960,857
Total Deposits	979,685	999,985	1,059,124	1,057,586	1,006,991
Investment Securities	268,342	303,937	303,886	267,300	207,704
Federal Home Loan Bank Stock	3,364	5,398	6,064	6,345	6,272
Stockholders' Equity	95,759	96,613	92,959	89,275	83,215
Selected Income Statement Data					
Interest Income	47,289	51,793	58,738	65,847	75,297
Interest Expense	11,016	16,806	21,523	26,281	37,922
Net Interest Income	36,273	34,987	37,215	39,566	37,375
Provision for Loan Losses	6,785	8,250	13,350	43,445	12,938
Other Income	9,733	9,951	10,006	9,544	9,005
Other Expense	35,379	33,051	33,856	34,844	30,856
Income (Loss) Before Tax	3,842	3,637	15	(29,179)	2,586
Income Tax Expense (Benefit)	1,201	1,104	(459)	(9,995)	557
Net Income (Loss)	2,641	2,533	474	(19,184)	2,029
Preferred Stock Dividends	1,435	1,400	1,400	1,365	-
Net Income (Loss) Available to Common Stockholders	$1,206	$1,133	$(926)	$(20,549)	$2,029
Weighted Average Common Shares Outstanding	8,439	8,439	8,149	7,213	7,199
Shares Outstanding	8,439	8,439	8,443	7,229	7,212
Intangible Assets	$224	$259	$295	$331	$2,779
Dividends Declared	-	-	-	1,057	2,814
Average Assets	1,139,814	1,205,891	1,269,607	1,286,418	1,204,846
Average Stockholders' Equity	96,541	94,737	94,452	105,655	84,372
Net Charge-Offs	9,698	20,880	16,471	29,060	11,435
Reserve for Loan Losses	12,737	15,650	28,280	31,401	17,016
OREO	15,941	20,445	20,208	19,705	12,812
Nonperforming Loans	29,855	38,837	28,921	33,566	35,374
Nonperforming Assets	46,162	59,708	49,262	53,403	48,186
Average Interest-Earning Assets	1,066,333	1,132,523	1,199,216	1,218,153	1,144,927
Noninterest-Bearing Deposits	123,967	94,269	102,959	84,239	77,497

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	Year Ended December 31, 2012	2011	2010	2009	2008
	(Dollars in Thousands, except per share data)				
Per Share Data:					
Net Income (Loss) Per Common Share (Diluted)	$0.14	$0.13	$(0.11)	$(2.85)	$0.28
Common Book Value Per Share	8.05	8.17	7.75	8.57	11.54
Tangible Common Book Value Per Share	8.02	8.14	7.72	8.52	11.15
Dividends Per Common Share	0.00	0.00	0.00	0.15	0.39
Profitability Ratios:					
Net Income (Loss) to Average Assets	0.11 %	0.09 %	(0.07)%	(1.60)%	0.17 %
Net Income (Loss) to Average Stockholders' Equity	1.25	1.20	(0.98)	(19.45)	2.40
Net Interest Margin	3.41	3.11	3.12	3.27	3.30
Loan Quality Ratios:					
Net Charge-Offs to Total Loans	1.30	2.92	2.03	3.12	1.19
Reserve for Loan Losses to Total Loans and OREO	1.67	2.12	3.39	3.30	1.75
Nonperforming Assets to Total Loans and OREO	6.05	8.10	5.91	5.62	4.95
Reserve for Loan Losses to Nonperforming Loans	42.66	40.30	97.78	93.55	48.10
Reserve for Loan Losses to Total Nonperforming Assets	27.59	26.21	57.41	58.80	35.31
Liquidity Ratios:					
Loans to Total Deposits (2)	76.23	71.63	76.78	88.06	95.42
Loans to Average Earning Assets (2)	70.04	63.24	67.81	76.45	83.92
Noninterest-Bearing Deposits to Total Deposits	12.65	9.43	9.72	7.97	7.70
Capital Adequacy Ratios:					
Common Stockholders' Equity to Total Assets	5.96	5.77	5.13	4.74	6.64
Total Stockholders' Equity to Total Assets	8.40	8.08	7.29	6.83	6.64
Dividend Payout Ratio	0.00	0.00	NM(1)	NM(1)	139.29

(1) Not meaningful due to net loss recorded.
(2) Total loans, net of unearned interest and fees.

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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 simi 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.

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- 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 Memorandum of Understanding.

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.

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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 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, 2012 and 2011, and results of operations for each of the years in the three-year period ended December 31, 2012. 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.

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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 $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 compared to $(0.93) million, or $(0.11) diluted per common share in 2010.

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

	2012	2011	2010
Taxable-Equivalent Net Interest Income	$36,417	$35,178	$37,393
Taxable-Equivalent Adjustment	144	191	178
Net Interest Income	36,273	34,987	37,215
Provision for Loan Losses	6,785	8,250	13,350
Noninterest Income	9,733	9,951	10,007
Noninterest Expense	35,379	33,051	33,857
Income Before Income Taxes	3,842	3,637	15
Income Taxes (Benefits)	1,201	1,104	(459)
Net Income	$2,641	$2,533	$474
Preferred Stock Dividends	1,435	1,400	1,400
Net Income (Loss) Available to			
Common Stockholders	$1,206	$1,133	$(926)
Basic per Common Share:			
Net Income (Loss)	$0.14	$0.13	$(0.11)
Diluted per Common Share:			
Net Income (Loss)	$0.14	$0.13	$(0.11)
Return on Average Assets:			
Net Income (Loss)	0.11%	0.09%	(0.07)%
Return on Average Equity:			
Net Income (Loss)	1.25%	1.20%	(0.98)%

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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.

Net income available to common shareholders for 2011 increased $2.06 million, or 222.35 percent, compared to 2010. The increase was primarily the result of a $5.1 million decrease in provision for loan losses and a decrease of $805 thousand in noninterest expense. The impact of these items was partly offset by a $2.23 million decrease in net interest income, a decrease of $55 thousand in noninterest income and an increase of $1.56 million 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 78.84 percent of total revenue during 2012 and 77.86 percent during 2011.

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 2013, which should benefit Colony's net interest margin.

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.

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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 2011 to 2012 (a)			Changes From 2010 to 2011 (a)		
	Volume	Rate	Total	Volume	Rate	Total
Interest Income						
Loans, Net-Taxable	$(2,406)	$(133)	$(2,539)	$(6,117)	$(1,149)	$(7,266)
Investment Securities						
Taxable	(377)	(1,630)	(2,007)	831	(581)	250
Tax-Exempt	(2)	(14)	(16)	46	(15)	31
Total Investment Securities	(379)	(1,644)	(2,023)	877	(596)	281
Interest-Bearing Deposits in Other Banks	(4)	34	30	(3)	28	25
Federal Funds Sold	(15)	(1)	(16)	15	5	20
Other Interest - Earning Assets	(12)	9	(3)	(3)	11	8
Total Interest Income	(2,816)	(1,735)	(4,551)	(5,231)	(1,701)	(6,932)
Interest Expense						
Interest-Bearing Demand and Savings Deposits	253	(227)	26	145	(549)	(404)
Time Deposits	(1,762)	(2,477)	(4,239)	(1,499)	(2,359)	(3,858)
Total Interest Expense On Deposits	(1,509)	(2,704)	(4,213)	(1,354)	(2,908)	(4,262)
Other Interest-Bearing Liabilities						
Federal Funds Purchased and Repurchase Agreements	(338)	-	(338)	(449)	385	(64)
Subordinated Debentures	-	46	46	-	(8)	(8)
Other Debt	(1,175)	(110)	(1,285)	(508)	125	(383)
Total Interest Expense	(3,022)	(2,768)	(5,790)	(2,311)	(2,406)	(4,717)
Net Interest Income (Loss)	$206	$1,033	$1,239	$(2,920)	$705	$(2,215)

(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.

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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 16.8 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 3.41 percent for 2012 compared to 3.11 percent for 2011 and to 3.12 percent for 2010. 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 2012, we have seen our net interest margin reach a low of 3.23 percent for first quarter 2012 to a high of 3.56 percent for third quarter 2012.

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Taxable-equivalent net interest income for 2012 increased by $1.24 million, or 3.52 percent, compared to 2011 while taxable-equivalent net interest income for 2011 decreased by $2.21 million, or 5.92 percent, compared to 2010. 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. Improvement in the net interest margin in 2012 was primarily driven by reduction in the cost of funds and maintaining longer term investments. Similarly, the average volume of earning assets during 2011 decreased $66.69 million compared to 2010 while over the same period the net interest margin decreased to 3.11 from 3.12 percent. The decline in average earning assets in 2012 affected each category of assets, while the significant decrease was primarily in average loans and investment securities. Growth in average earning assets during 2011 and 2010 was primarily in fed funds sold and investment securities, while average loans outstanding decreased significantly. The slight reduction in the net interest margin in 2011 was primarily the result of the decrease in average earning assets and maintenance of a higher liquidity level.

The average volume of loans decreased $41.20 million in 2012 compared to 2011 and decreased $102.12 million in 2011 compared to 2010. The average yield on loans decreased 1 basis point in 2012 compared to 2011 and decreased 15 basis points in 2011 compared to 2010. The average volume of deposits decreased $31.03 million while other borrowings decreased $37.83 million in 2012 compared to 2011. The average volume of other borrowings decreased $30.42 million in 2011 compared to 2010 while average deposits decreased $33.54 million in 2011 compared to 2010. Interest-bearing deposits made up 125.76 percent of the decrease in average deposits in 2012 and 135.02 percent of the decrease in average deposits in 2011. Accordingly, the ratio of average interest-bearing deposits to total average deposits was 89.5 percent in 2012, 90.6 percent in 2011 and 92.1 percent in 2010. This deposit mix, combined with a general decrease in interest rates, had the effect of (i) decreasing the average cost of total deposits by 39 basis points in 2012 compared to 2011 and decreasing the average cost of total deposits by 37 basis points in 2011 compared to 2010, 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 3.27 percent in 2012 compared to 2.93 percent in 2011 and 2.94 percent in 2010. 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 $6.79 million in 2012 compared to $8.25 million in 2011 and $13.35 million in 2010. See the section captioned “Allowance for Loan Losses” elsewhere in this discussion for further analysis of the provision for loan losses.

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Noninterest Income

The components of noninterest income were as follows:

	2012	2011	2010
Service Charges on Deposit Accounts	$3,573	$3,244	$3,597
Other Charges, Commissions and Fees	1,515	1,312	1,140
Other	1,102	1,259	1,335
Mortgage Fee Income	400	265	313
Securities Gains	2,837	2,924	2,617
SBA Premiums	306	947	1,005
	$9,733	$9,951	$10,007

Total noninterest income for 2012 decreased $218 thousand, or 2.19 percent, compared to 2011 while total noninterest income for 2011 decreased $56 thousand, or 0.56 percent, compared to 2010. The decrease in 2012 noninterest income compared to 2011 was primarily in SBA premiums while the decrease in 2011 noninterest income compared to 2010 was primarily in mortgage fee income, SBA premiums, and service charges on deposit accounts. 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 2012 increased $329 thousand, or 10.14 percent, compared to 2011. Service charges on deposit accounts for 2011 decreased $353 thousand, or 9.81 percent, compared to 2010. The increase in 2012 was primarily due to an increase in volume of consumer and business account overdraft fees.

Mortgage Fee Income. Mortgage fee income for 2012 increased $135 thousand, or 50.94 percent, compared to 2011 while mortgage fee income for 2011 decreased $48 thousand, or 15.34 percent, compared to 2010. The increase in 2012 was due to increased mortgage loan activity due to an initiative to increase mortgage lending opportunities given the low interest rate environment. The decrease in 2011 was primarily due to decreased mortgage loan activity with the housing and real estate downturn.

Security Gains. The Company realized gains from the sale of securities of $2.83 million for 2012 compared to $2.92 million for 2011 and $2.62 million in 2010.

All Other Noninterest Income. Other charges, commissions and fees, other income and SBA premiums for 2012 decreased $595 thousand, or 16.91 percent, compared to 2011. The decrease was primarily attributable to the decline in SBA premiums. In 2011 other charges, commissions and fees, other income and SBA premiums for 2011 increased $38 thousand, or 1.09 percent, compared to 2010. The increase was primarily attributable to increased ATM and bank debit card interchange fees for 2011 compared to 2010.

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Noninterest Expense

The components of noninterest expense were as follows:

	2012	2011	2010
Salaries and Employee Benefits	$15,565	$14,633	$14,098
Occupancy and Equipment	3,878	3,998	4,422
Other	15,936	14,420	15,337
	$35,379	$33,051	$33,857

Total noninterest expense for 2012 increased $2.33 million, or 7.04 percent compared to 2011 while total noninterest expense decreased $806 thousand, or 2.38 percent compared to 2010. Growth in noninterest expense in 2012 was primarily in salaries and employee benefits and noninterest expense while the Company had a slight decrease in occupancy and equipment. Reduction in noninterest expense in 2011 was primarily in occupancy and equipment and other noninterest expense while the Company had a slight increase in salaries and employee benefits.

Salaries and Employee Benefits. Salaries and employee benefits expense for 2012 increased $932 thousand, or 6.37 percent, compared to 2011. This increase is primarily attributable to an increase in headcount related to increased regulatory compliance demands. Salaries and employee benefits expense for 2011 increased $535 thousand, or 3.80 percent, compared to 2010.

Occupancy and Equipment. Net occupancy expense for 2012 decreased $120 thousand compared to 2011, or a decrease of 3.00 percent. Net occupancy expense for 2011 decreased $424 thousand compared to 2010, or a decrease of 9.59 percent. The decrease in occupancy expense in 2011 is primarily due to a reduction in depreciation expense of $351 thousand from 2010.

All Other Noninterest Expense. 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, 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, foreclosed property and repossession expense increased to $5.6 million in 2012 compared to $4.0 million in 2011, or an increase of $1.57 million, and advertising decreased to $423 thousand in 2012 compared to $508 thousand in 2011, or a decrease of $86 thousand. All other noninterest expense for 2011 decreased $917 thousand, or 5.98 percent. Significant changes in noninterest expense were: FDIC insurance assessment fees decreased to $1.83 million for 2011 compared to $1.87 million for 2010, or a decrease of $38 thousand; foreclosed property and repossession expense decreased to $4.0 million for 2011 compared to $4.9 million for 2010, or a decrease of $898 thousand, legal and professional fees decreased to $1.2 million for 2011 in comparison to $1.4 million for 2010, or a decrease of $183 thousand, and advertising decreased to $568 thousand in 2011 compared to $743 thousand, or 4.59 percent.

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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 $1.14 billion in 2012 compared to 1.21 billion in 2011 and $1.27 billion in 2010.

	2012			2011			2010		
Sources of Funds:									
Deposits:									
Noninterest-Bearing	$101,896	8.9	%	$93,903	7.8	%	$82,160	6.5	%
Interest-Bearing	867,794	76.1		906,816	75.2		952,095	75.0	
Federal Funds Purchased and Repurchase Agreements	-	-		9,851	0.8		26,070	2.0	
Subordinated Debentures and Other Borrowed Money	67,974	6.0		95,949	8.0		110,149	8.7	
Other Noninterest-Bearing Liabilities	5,609	0.5		4,635	0.4		4,681	0.4	
Equity Capital	96,541	8.5		94,737	7.8		94,452	7.4	
Total	$1,139,814	100.0	%	$1,205,891	100.0	%	$1,269,607	100.0	%
Uses of Funds:									
Loans	$706,091	62.0	%	$742,482	61.6	%	$834,739	65.8	%
Investment Securities	284,261	24.9		300,293	24.9		267,015	21.0	
Federal Funds Sold	38,877	3.4		44,667	3.7		38,809	3.1	
Interest-Bearing Deposits	17,046	1.5		18,715	1.5		21,911	1.7	
Other Interest-Earning Assets	4,277	0.4		5,781	0.5		6,297	0.5	
Other Noninterest-Earning Assets	89,262	7.8		93,953	7.8		100,836	7.9	
Total	$1,139,814	100.0	%	$1,205,891	100.0	%	$1,269,607	100.0	%

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 89.5 percent of total average deposits in 2012 compared to 90.62 percent in 2011 and 92.06 percent in 2010.

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 2012 as total loans were $747.1 million at December 31, 2012, up 4.3 percent, compared to loans of $716.3 million at December 31, 2011, while total loans at December 31, 2011 were down 11.9 percent, compared to loans of $813.3 million at December 31, 2010. 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.

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Loans

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

	2012	2011	2010	2009	2008
Commercial, Financial and Agricultural	$61,895	$57,408	$63,772	$80,984	$86,379
Real Estate					
Construction	59,660	62,076	76,682	113,117	160,374
Mortgage, Farmland	49,057	48,225	52,778	54,965	54,159
Mortgage, Other	538,231	508,919	570,350	626,993	600,653
Consumer	29,778	30,449	33,564	38,383	44,163
Other	8,429	9,244	16,104	16,950	15,308
	747,050	716,321	813,250	931,392	961,036
Unearned Interest and Fees	(234)	(57)	(61)	(140)	(179)
Allowance for Loan Losses	(12,737)	(15,650)	(28,280)	(31,401)	(17,016)
Loans	$734,079	$700,614	$784,909	$899,851	$943,841

The following table presents total loans as of December 31, 2012 according to maturity distribution and/or repricing opportunity on adjustable rate loans.

Maturity and Repricing Opportunity

One Year or Less	$362,748
After One Year through Three Years	297,333
After Three Years through Five Years	44,758
Over Five Years	42,211
	$747,050

Overview. Loans totaled $747.1 million at December 31, 2012, up 4.3 percent from December 31, 2011 loans of $716.3 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 72.05 percent and 71.04 percent of total loans, real estate construction made up 7.99 percent and 8.67 percent while commercial financial and agricultural loans made up 8.29 percent and 8.01 percent of total loans at December 31, 2012 and December 31, 2011, 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.

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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, 2012 increased 7.82 percent from December 31, 2011 to $61.90 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, 2012 and December 31, 2011, 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.

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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, 2012, approximately 86.60 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 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, 2012 and December 31, 2011.

	December 31, 2012			December 31, 2011		
		Period End Balances			Period End Balances	
	Number of Relationships	Committed	Outstanding	Number of Relationships	Committed	Outstanding
Large Credit Relationships:						
$10 million and greater	1	$10,276	$10,276	1	$11,811	$11,811
$5 million to $9.9 million	13	88,248	72,179	5	31,363	31,363

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, 2012. 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	$244,450	$295,346	$42,668	$39,413	$621,877
Loans with floating interest rates	118,298	1,987	2,090	2,798	125,173

Total	$362,748	$297,333	$44,758	$42,211	$747,050

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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:

	2012	2011	2010	2009	2008
Loans Accounted for on Nonaccrual	$29,851	$38,822	$28,902	$33,535	$35,124
Loans Past Due 90 Days or More	4	15	19	31	250
Other Real Estate Foreclosed	15,941	20,445	20,208	19,705	12,812
Securities Accounted for on Nonaccrual	366	426	132	132	---
Total Nonperforming Assets	$46,162	$59,708	$49,261	$53,403	$48,186
Nonperforming Assets as a Percentage of:					
Total Loans and Foreclosed Assets	6.05 %	8.10 %	5.91 %	5.62 %	4.95 %
Total Assets	4.05 %	4.99 %	3.86 %	4.09 %	3.85 %
Supplemental Data:					
Trouble Debt Restructured Loans In Compliance with Modified Terms	$24,870	$29,839	$26,556	$9,269	$---
Trouble Debt Restructured Loans Past Due 30-89 Days	1,377	611	1,048	459	---
Accruing Past Due Loans:					
30-89 Days Past Due	14,911	7,161	19,740	25,547	18,675
90 or More Days Past Due	4	15	19	31	250
Total Accruing Past Due Loans	$14,915	$7,176	$19,759	$25,578	$18,925

Nonperforming assets include nonaccrual loans, loans past due 90 days or more, foreclosed real estate and nonaccrual securities. Nonperforming assets at December 31, 2012 decreased 22.69 percent from December 31, 2011.

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.

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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.

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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 resulted in a reduction in the ALLL estimate of $2,154,639. 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.

	2012		2011		2010		2009		2008	
	Reserve	% *	Reserve	% *	Reserve	% *	Reserve	% *	Reserve	% *
Commercial, Financial and Agricultural	$1,277	8 %	$1,368	8 %	$5,113	8 %	$4,710	9 %	$4,254	9 %
Real Estate - Construction	2,028	8	3,261	9	4,646	9	7,850	12	2,808	17
Real Estate - Farmland	291	7	365	7	944	7	942	6	681	6
Real Estate - Other	8,569	72	10,143	71	13,972	70	13,816	67	5,955	62
Loans to Individuals	228	4	205	4	3,074	4	2,826	4	2,467	4
All other loans	344	1	308	1	531	2	1,257	2	851	2
Total	$12,737	100 %	$15,650	100 %	$28,280	100 %	$31,401	100 %	$17,016	100 %

* 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.

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

	2012		2011		2010		2009		2008	
Allowance for Loan Losses at Beginning of Year	$ 15,650		$ 28,280		$ 31,401		$ 17,016		$ 15,513	
Charge-Offs										
Commercial, Financial and Agricultural	656		1,297		725		768		1,680	
Real Estate	9,618		21,215		15,309		27,545		9,190	
Consumer	169		223		549		908		994	
All Other	11		115		1,040		272		103	
	10,454		22,850		17,623		29,493		11,967	
Recoveries										
Commercial, Financial and Agricultural	140		582		82		73		73	
Real Estate	494		1,235		774		156		285	
Consumer	82		145		246		191		155	
All Other	40		8		50		13		19	
	756		1,970		1,152		433		532	
Net Charge-Offs	9,698		20,880		16,471		29,060		11,435	
Provision for Loans Losses	6,785		8,250		13,350		43,445		12,938	
Allowance for Loan Losses at End of Year	$ 12,737		$ 15,650		$ 28,280		$ 31,401		$ 17,016	
Ratio of Net Charge-Offs to Average Loans	1.34	%	2.74	%	1.90	%	3.02	%	1.19	%

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 $1.47 million from $8.25 million in 2011 to $6.79 million in 2012. 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 2012 was the reduction in the net charge-offs in 2012 to $9.70 million from $20.88 million in 2011. 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.

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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 6.05 percent at December 31, 2012 compared to 8.10 percent at December 31, 2011. Total nonperforming assets at December 31, 2012 were $46.2 million, of which $23.9 million were construction, land development and other land loans; $2.4 million were farmland properties; $7.2 million were 1-4 family residential properties; $0.6 million were multifamily properties; $10.4 million were nonfarm nonresidential properties; and the remainder of nonperforming assets totaling $1.7 million were commercial and consumer loans. Total nonperforming assets at December 31, 2011 were $59.7 million, of which $35.5 million were construction, land development and other land loans; $4.6 million were 1-4 family residential properties; $0.7 million were multifamily properties; $15.3 million were nonfarm nonresidential properties; $0.7 million were farmland properties; and the remainder of nonperforming assets totaling $2.9 million were commercial and consumer loans. All of the classified loans greater than $50 thousand, including the nonperforming loans, are reviewed each quarter for impairment. The allowance for loan losses of $12.7 million at December 31, 2012 was 1.70 percent of total loans which compares to $15.6 million at December 31, 2011, or 2.18 percent of total loans and to $28.3 million at December 31, 2010, or 3.48 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 4.00 percent, 5.42 percent, and 3.56 percent, respectively as of December 31, 2012, December 31, 2011 and December 31, 2010, the Company's allowance for loan losses as a percentage of nonperforming loans was 42.66 percent, 40.29 percent, and 97.78 percent, respectively as of December 31, 2012, December 31, 2011 and December 31, 2010. We continue to identify new problem loans, though at a slower pace than the previous year.

While the allowance for loan losses decreased from $15.65 million, or 2.18 percent of total loans at December 31, 2011 to $12.74 million, or 1.71 percent of total loans at December 31, 2012, the Company also reflected a decrease in nonperforming loans from $38.84 million at December 31, 2011 to $29.86 million at December 31, 2012. 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. 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 $50 thousand and over. The remaining portfolio is analyzed based on historical loss data. Loans selected for individual review where no individual impairment amount is identified do not receive a contribution to the allowance for loan losses based on historical 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.

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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 $50 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 significant reduction in collateral values on nonperforming assets has resulted in charge-offs particularly during 2012.

The allowance for loan losses is $2.91 million 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 2012 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, 2012. 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, 2012, 2011 and 2010.

	2012	2011	2010
Obligations of States and Political Subdivisions	$ 4,046	$ 7,630	$ 3,305
Corporate Obligations	1,105	2,114	1,986
Asset-Backed Securities	132	132	132
Investment Securities	5,283	9,876	5,423
Mortgage-Backed Securities	263,059	294,061	298,463
Total Investment Securities and Mortgage-Backed Securities	$ 268,342	$ 303,937	$ 303,886

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The following table represents expected maturities and weighted-average yields of investment securities held by the Company as of December 31, 2012. (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	$35,639	(0.97)%	$112,374	1.39 %	$73,161	1.64 %	$41,885	1.89 %
Obligations of State and Political Subdivisions	827	3.69	1,788	2.71	1,431	3.71	-	-
Corporate Obligations	-	-	1,105	4.48	-	-	-	-
Asset-Backed Securities	-	-	-	-	-	-	132	-
Total Investment Portfolio	$36,466	(0.87)%	$115,267	1.44 %	$74,592	1.68 %	$42,017	1.87 %

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, 2012, 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 1.82 percent in 2012 compared to 2.39 percent in 2011 and 2.59 percent in 2010. The decrease in the average yield from 2011 to 2012 and from 2010 to 2011 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 2012, 2011 and 2010.

	2012		2011		2010	
	Average Amount	Average Rate	Average Amount	Average Rate	Average Amount	Average Rate
Noninterest-Bearing Demand Deposits	$101,896		$93,903		$82,160	
Interest-Bearing Demand and Savings	329,984	0.38 %	273,783	0.45 %	251,537	0.65 %
Time Deposits	537,810	1.39 %	633,033	1.85 %	700,558	2.22 %
Total Deposits	$969,690	0.90 %	$1,000,719	1.29 %	$1,034,255	1.66 %

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The following table presents the maturities of the Company's other time deposits as of December 31, 2012.

	Other Time Deposits $100,000 or Greater	Other Time Deposits Less Than $100,000	Total
Months to Maturity			
3 or Less	$ 50,559	$ 80,838	$ 131,397
Over 3 through 12	110,971	146,116	257,087
Over 12 Months	49,715	54,711	104,426
	$ 211,245	$ 281,665	$ 492,910

Average deposits decreased $31.03 million in 2012 compared to 2011 and decreased $33.54 million in 2011 compared to 2010. The decrease in 2012 included $95.22 million, or 15.04 percent in time deposits while, at the same time, noninterest bearing deposits increased $7.99 million, or 8.51 percent and interest-bearing demand and savings deposits increased $56.20 million, or 20.53 percent. The decrease in 2011 included $67.53 million, or 9.6 percent in time deposits while, at the same time, noninterest bearing deposits increased $11.74 million, or 14.29 percent and interest-bearing demand and savings deposits increased $22.25 million, or 8.84 percent. Accordingly, the ratio of average noninterest-bearing deposits to total average deposits was 10.51 in 2012, 9.4 percent in 2011 and 7.9 percent in 2010. 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. The general decrease in market rates in 2011 had the effect of (i) decreasing the average cost of interest-bearing deposits by 38 basis points in 2011 compared to 2010 and (ii) mitigating a portion of the impact of decreasing yields on earning assets in the Company's net interest income in 2011.

Total average interest-bearing deposits decreased $39.0 million, or 4.3 percent in 2012 compared to 2011 and decreased $45.3 million, or 4.8 percent in 2011 compared to 2010. The decrease in average deposits in 2012 compared to 2011 was time deposit accounts.

The Company supplements deposit sources with brokered deposits. As of December 31, 2012, the Company had $28.2 million, or 2.88 percent of total deposits, in brokered certificates of deposit attracted by external third parties. Additional information is provided in the Footnote for Deposits.

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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, 2012. 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.

	Payments Due by Period				
	1 Year or Less	More than 1 Year but Less Than 3 Years	3 Years or More but Less Than 5 Years	5 Years or More	Total
Contractual Obligations:					
Subordinated Debentures	$-	$-	$-	$24,229	$24,229
Federal Home Loan Bank Advances	-	-	9,000	26,000	35,000
Operating Leases	132	94	84	-	310
Deposits with Stated Maturity Dates	388,484	87,464	16,931	31	492,910
	388,616	87,558	26,015	50,260	552,449
Other Commitments:					
Loan Commitments	64,147	-	-	-	64,147
Standby Letters of Credit	1,141	-	-	-	1,141
	65,288	-	-	-	65,288
Total Contractual Obligations and Other Commitments	$453,904	$87,558	$26,015	$50,260	$617,737

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.

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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, 2012 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, 2012 are included in the preceding table.

Capital and Liquidity

At December 31, 2012, shareholders' equity totaled $95.8 million compared to $96.6 million at December 31, 2011. In addition to net income of $2.6 million, other significant changes in shareholders' equity during 2012 included $1.4 million of dividends declared on preferred stock. The accumulated other comprehensive income component of shareholders' equity totaled $(150) thousand at December 31, 2012 compared to $1.9 million at December 31, 2011. 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, 2012 was 15.22 percent and total Tier 1 and 2 risk-based capital was 16.47 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, 2012 was 10.22 percent, which exceeds the required ratio standard of 4 percent.

For 2012, average capital was $96.5 million, representing 8.47 percent of average assets for the year. This compares to 7.86 percent for 2011.

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The Company did not pay any common stock dividends in 2012 or 2011. The Company suspended dividend payments beginning in the third quarter of 2009.

The Company declared dividends of $1,435 and $1,400 on preferred stock during 2012 and 2011, respectively. The Company deferred all dividend payments declared in 2012 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, 2012, the available for sale bond portfolio totaled $268.3 million. At December 31, 2011, the Company held $303.9 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 76.3 percent as of December 31, 2012 and 71.6 percent at December 31, 2011. 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, 2012 and December 31, 2011 were 73.6 percent and 66.9 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, 2012 and December 31, 2011, the Bank had $211 million and $248 million, respectively, in certificates of deposit of $100,000 or more. These larger deposits represented 21.6 percent and 24.8 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.

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The Company supplemented deposit sources with brokered deposits. As of December 31, 2012, the Company had $28.2 million, or 2.88 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, 2012, the Company had $33.6 million, or 3.43 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.

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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.

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Quantitative and Qualitative Disclosures About Market Risk
AVERAGE BALANCE SHEETS

	2012			2011			2010		
	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)	$721,872	$42,054	5.83%	$763,067	$44,593	5.84%	$865,184	$51,859	5.99%
Investment Securities									
Taxable	280,959	5,005	1.78	296,948	7,012	2.36	264,494	6,762	2.56
Tax-Exempt (2)	3,302	155	4.69	3,345	171	5.11	2,521	140	5.55
Total Investment Securities	284,261	5,160	1.82	300,293	7,183	2.39	267,015	6,902	2.59
Interest-Bearing Deposits	17,046	77	0.45	18,715	47	0.25	21,911	22	0.10
Federal Funds Sold	38,877	99	0.25	44,667	115	0.26	38,809	95	0.25
Other Interest-Earning Assets	4,277	43	1.01	5,781	46	0.80	6,297	38	0.60
Total Interest-Earning Assets	1,066,333	47,433	4.45	1,132,523	51,984	4.59	1,199,216	58,916	4.92
Noninterest-Earning Assets									
Cash	18,474			19,057			19,347		
Allowance for Loan Losses	(15,781)			(20,585)			(30,445)		
Other Assets	70,788			74,896			81,489		
Total Noninterest-Earning Assets	73,481			73,368			70,391		
Total Assets	$1,139,814			$1,205,891			$1,269,607		
Liabilities and Stockholders' Equity									
Interest-Bearing Liabilities									
Interest-Bearing Demand and Savings	$329,984	$1,258	0.38%	$273,783	$1,232	0.45%	$251,537	$1,636	0.65%
Other Time	537,810	7,479	1.39	633,033	11,718	1.85	700,558	15,576	2.22
Total Interest-Bearing	867,794	8,737	1.01	906,816	12,950	1.43	952,095	17,212	1.81

Deposits									
Other Interest-Bearing Liabilities									
Other Borrowed Money	43,745	1,725	3.94	71,720	3,010	4.20	85,920	3,074	3.58
Subordinated Debentures	24,229	554	2.29	24,229	508	2.10	24,229	516	2.13
Federal Funds Purchased and Repurchase Agreements	-	-	-	9,851	338	3.43	26,070	721	2.77
Total Other Interest-Bearing Liabilities	67,974	2,279	3.35	105,800	3,856	3.64	136,219	4,311	3.17
Total Interest-Bearing Liabilities	935,768	11,016	1.18	1,012,616	16,806	1.66	1,088,314	21,523	1.98
Noninterest-Bearing Liabilities and Stockholders' Equity									
Demand Deposits	101,896			93,903			82,160		
Other Liabilities	5,609			4,635			4,681		
Stockholders' Equity	96,541			94,737			94,452		
Total Noninterest-Bearing Liabilities and Stockholders' Equity	204,046			193,275			181,293		
Total Liabilities and Stockholders' Equity	$1,139,814			$1,205,891			$1,269,607		
Interest Rate Spread			3.27%			2.93%			2.94%
Net Interest Income		$36,417			$35,178			$37,393	
Net Interest Margin			3.41%			3.11%			3.12%

(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 $91, $133 and $130 for 2012, 2011 and 2010 respectively, are included in interest on loans. The adjustments are based on a federal tax rate of 34 percent.

(2) Taxable-equivalent adjustments totaling $53, $58 and $48 for 2012, 2011 and 2010 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.

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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, 2012. 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.

	Assets and Liabilities Repricing Within					
	3 Months or Less	4 to 12 Months	1 Year	1 to 5 Years	Over 5 Years	Total
EARNING ASSETS:						
Interest-Bearing Deposits	$21,795	$-	$21,795	$-	$-	$21,795
Federal Funds Sold	20,002	-	20,002	-	-	20,002
Investment Securities	126	-	126	132,553	135,663	268,342
Loans, Net of Unearned Income	219,181	143,450	362,631	341,974	42,211	746,816
Other Interest- Earning Assets	3,364	-	3,364	-	-	3,364
Total Interest-Earning Assets	264,468	143,450	407,918	474,527	177,874	1,060,319
INTEREST-BEARING LIABILITIES:						
Interest-Bearing Demand Deposits (1)	314,031	-	314,031	-	-	314,031
Savings (1)	48,778	-	48,778	-	-	48,778
Time Deposits	131,397	257,087	388,484	104,395	31	492,910
Other Borrowings (2)	-	-	-	9,000	26,000	35,000
Subordinated Debentures	24,229	-	24,229	-	-	24,229
Total Interest-Bearing Liabilities	518,435	257,087	775,522	113,395	26,031	914,948
Interest Rate-Sensitivity Gap	(253,967)	(113,637)	(367,604)	361,132	151,843	$145,371
Cumulative Interest-Sensitivity Gap	$(253,967)	$(367,604)	$(367,604)	$(6,472)	$145,371	