Management's Discussion and Analysis for the Year Ended December 31, 2018

Summary

Florida Capital Group, Inc. (the "Company") reported net income of $5.65 million for the year ended December 31, 2018 compared to net income of $594 thousand for 2017. Current year earnings include a $4.6 million deferred tax benefit (and related deferred tax asset) representing the estimated tax benefits associated with the future utilization of the Company's financial crisis net operating losses. Net of this tax effect, reported net income was $1.05 million compared to $594 thousand reported in 2017. This modest earnings improvement does not reflect the full year impact of the numerous steps the board and management took last year to improve profitability and generate greater shareholder returns. Management anticipates these actions will manifest themselves in improved earnings and returns for 2019.

The following notable activities were undertaken during 2018 with the goal to improve operating results: 1) measuring and managing the financial results of the bank by line of business – mortgage, warehouse lending, government guaranteed lending (GGL), electronic banking and the community bank; 2) reducing staffing levels significantly and continuing to add technology where appropriate to improve operating efficiencies; and 3) establishing an internal working group to assess and make recommendations relative to improving earnings and managing risk in all lines of business.

Mortgage Line of Business

As 2018 began, substantial mortgage market headwinds were underway with predictions of lower origination activity reinforced by a pricing war that continues to see key mortgage market participants exiting the business entirely. For the year, mortgage production (wholesale and retail channels) was $747 million, which was slightly in excess of the budgeted level and comparable to 2017; however, from a pricing perspective, the margin of 1.38% trailed the budgeted margin of 1.55%. Management has reduced staff, and is assessing several opportunities to reduce fixed costs or to convert fixed costs to variable costs. An internal mortgage cost study has provided the data required to analyze profitability at a very granular level. Higher interest rates and structural impediments – declining new home construction and sales along with higher home prices – continue to contribute adversely to a very challenging mortgage market.

Warehouse Line of Business

Warehouse lending reported total production in excess of $2.0 billion, which exceeded 2017 production. For the same period, average year-to-date warehouse lending balances exceeded budget by $12 million or 23% and this line of business remains a significant contributor to overall profitability. Activity accelerated at the end of 2018 with year-end balances of $89 million, and this level of activity has continued in 2019 during which warehouse is anticipated to do $2.0 billion of production again in spite of the projected weaker mortgage market. Gross commitments are approximately $300 million and utilization rates have been running between 25% and 30% recently.

Government Guaranteed Lending (GGL)

The restructuring of this business line that began in 2017 successfully paved the way for $29 million in originations and a solid contribution to overall bank profitability in 2018. A "direct to backroom" approach for smaller SBA 7(a) originations was refined during the year. This approach uses referral sources to create activity which is then directly credit-scored and underwritten in the bank's credit administration area. This approach does not use traditional business development officers, and is highly efficient and cost effective. The bank also originated several larger USDA-guaranteed loan relationships. The guaranteed portion of production is generally sold in the secondary market and the bank reported $1.6 million of secondary market gains on sale in 2018.

Electronic Banking

This emerging line of business is comprised of three sub-lines – fee-based ACH third party payment processing, money service business relationships that require cash handling, and a deposit generating, card-based program. In less than three years, electronic banking has generated in excess of $100 million (as of February 2019) of non-interest bearing deposits, and has become a strategic source of very low cost funding for both the mortgage and warehouse lines of business. During 2018, management made the strategic choice to focus more on deposit generation and less on fee generation, which has dramatically reduced the bank's cost of funds at a time when market-based sources have become increasingly expensive.

Community Bank

Management has recently focused efforts in this line of business toward core deposit retention after several years of shrinking the balance sheet through sales of branches. As market interest rates have increased, the competition for core deposits has become challenging with numerous bank and non-bank competitors offering rates and rate "teasers" that in many cases exceed the cost of wholesale funding. Management determined during 2018 that it would increase rates to the level required to retain deposits, but would not pay irrational rates to retain or attract deposits. Traditional community bank commercial lending – primarily real estate focused - continues in the bank's target markets.

Balance Sheet

Total assets of $406 million at year end 2018 approximated the $416 million reported at the end of 2017. Loans receivable declined $5 million to $270 million, but within the portfolio warehouse lending balances increased $10 million year over year, while commercial lending balances declined by the same amount. Commercial lending balances are expected to continue to decline due to the difficulty of retaining lending relationships in markets the bank has exited.

During 2018, total deposits declined $33 million to $240 million. The lower deposit level was primarily the result of declines in money market accounts, which tend to be volatile at year end, and continuing maturities of retail certificates of deposit. These declines were partially offset by a $22 million increase in non-interest bearing deposits associated with the electronic banking line of business, which has continued to exceed expectations in early 2019. Resources will be focused on future core deposit growth in the electronic banking business line. As a result, the bank has increased its deposit rates in light of higher market interest rates in order to retain deposits, but does not intend to participate in the present irrational deposit pricing war. Other borrowings peaked at $127 million at the end of 2018 compared to $110 million at year end 2017. This increase was exclusively associated with the significant increase in warehouse lending balances at year end 2018. For the first two months of 2019, growth in electronic banking deposits has allowed the bank to trim its Federal Home Loan Bank advances substantially, which has averaged only $47 million during the first quarter of 2019 versus $70 million for the comparable 2018 period. This trend has dramatically lowered the bank's overall cost of funds. The Bank's liquidity position remains strong, capital is adequate, and asset quality trends remain stable.

Income Statement

For the year ended December 31, 2018, net interest income increased $700 thousand to $11.4 million. For 2018, interest income increased $2.3 million or 17% to $15.8 million, while interest expense rose $1.6 million or 38% to $4.3 million reflecting the generally higher level of interest rates prevailing during 2018. For the same period, non-interest income declined $1.3 million or 6% primarily due to lower mortgage gain on sale associated with the weaker 2018 mortgage market margins. For the comparable period, non-interest expenses decreased $1.0 million or 4%; however, this figure does not represent the full year impact of staff reductions throughout the bank, which totals $3.0 million a full-year basis. This staffing reduction impact is reflected in a comparison of March 2019 bank only year-to-date earnings of $525 thousand compared to a loss of $148 thousand for the same period in 2018.

Florida Capital Group, Inc. and Subsidiary
Consolidated Statements of Financial Condition
December 31, 2018 and 2017

	Audited December 31, 2018	Audited December 31, 2017
Assets:		
Cash and due from banks	$ 9,077,903	$ 10,629,121
Interest-bearing deposits in banks	15,539,877	9,347,096
Cash and cash equivalents	24,617,780	19,976,217
Securities available for sale	27,038,291	27,687,911
Restricted equity securities, at cost	5,661,741	5,906,000
Loans receivable, net of allowance for loan losses of $1,956,613 in 2018 and $2,206,486 in 2017	270,007,044	275,133,890
Loans held for sale	52,197,104	66,972,656
Accrued interest receivable	1,215,632	970,723
Foreclosed real estate	3,703,158	2,602,172
Premises and equipment, net	572,076	796,672
Cash surrender value of life insurance	10,559,325	10,309,724
Loan servicing rights, net	1,975,602	1,917,149
Deferred tax asset	4,600,170	-
Other assets	3,927,656	3,924,250
Total Assets	$ 406,075,579	$ 416,197,364
Liabilities:		
Noninterest-bearing demand deposits	$ 86,062,135	$ 63,809,685
Interest-bearing demand deposits	16,169,168	19,962,868
Money market and savings deposits	56,255,437	84,558,266
Time deposits	81,062,111	104,303,487
Total Deposits	239,548,851	272,634,306
Federal Home Loan Bank advances	102,000,000	109,950,000
Fed funds purchased	24,000,000	-
Repurchase agreements	1,472,021	348,158
Notes payable	150,000	-
Accrued interest payable	420,441	347,177
Accrued expense and other liabilities	2,006,931	2,026,444
Total Liabilities	369,598,244	385,306,085
Commitments and contingencies	-	-
Stockholders' Equity:		
Preferred stock Series A, 1,000,000 shares authorized; liquidation preference of $20 per share; 139,553 shares issued	2,791,060	2,791,060
Common stock, $.01 par value; 617,113,408 shares authorized, and 617,030,226 issued in 2018 and 2017	6,170,303	6,170,303
Additional paid-in capital	170,053,745	170,053,745
Accumulated deficit	(141,838,540)	(147,486,585)
Treasury stock, 375,763 and 221,422 shares at cost in 2018 and 2017, respectively	(3,191)	(1,648)
Accumulated other comprehensive loss	(696,042)	(635,596)
Total Stockholders' Equity	36,477,335	30,891,279
Total Liabilities & Stockholders' Equity	$ 406,075,579	$ 416,197,364

Florida Capital Group, Inc. and Subsidiary
Consolidated Statements of Income
Years Ended December 31, 2018 and 2017

	Audited For The Year Ended December 31, 2018	Audited For the Year Ended December 31, 2017
INTEREST INCOME:		
Loans receivable and fees on loans	$ 14,709,846	$ 12,588,068
Investment securities	554,131	516,421
Interest-bearing deposits in banks	492,453	336,670
Total interest income	15,756,430	13,441,159
INTEREST EXPENSE:		
Deposits	2,285,663	1,424,355
Other	2,060,567	1,275,904
Total interest expense	4,346,230	2,700,259
NET INTEREST INCOME	11,410,200	10,740,900
PROVISION FOR LOAN LOSSES	0	0
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	11,410,200	10,740,900
NONINTEREST INCOME:		
Service charges on deposit accounts	648,161	434,862
Mortgage banking income	13,825,851	16,436,506
Gain on sale of SBA Loans	1,626,398	1,234,405
Other income	2,319,943	1,593,759
Total noninterest income	18,420,353	19,699,532
NONINTEREST EXPENSE:		
Salaries and employee benefits	18,878,618	20,419,752
Occupancy and equipment expense	1,461,874	1,949,215
Data processing, communications and telephone	2,571,803	1,955,255
Loan related expense	220,646	461,581
Foreclosed real estate expense	359,290	247,253
Mortgage banking related expense	1,294,309	1,148,910
Regulatory fees	357,107	171,186
Professional fees	896,026	626,750
Marketing expense	1,128,545	844,811
Other expenses	1,614,460	2,021,303
Total noninterest expense	28,782,678	29,846,016
Income Before Income Taxes	1,047,875	594,416
Income Tax Benefit	4,600,170	-
Net Income	$ 5,648,045	$ 594,416