Florida Capital Group, Inc.

Management's Discussion and Analysis for the Quarter Ended March 31, 2019

Summary

Florida Capital Group, Inc. (the "Company") reported net income of $525 thousand for the quarter ended March 31, 2019 compared to a net loss of $148 thousand for the first quarter of 2018 - a $673 thousand improvement. First quarter 2019 earnings include $163 thousand of write-downs associated with foreclosed properties as well as a $150 thousand provision for loan losses to enhance the Company's reserve for credit losses. This is the first provision expense recorded by the Company since its recapitalization in 2012, and is made in recognition of continuing loan growth, and in contemplation of an uncertain economic climate. Adjusted for these items (non-GAAP basis of presentation), net income was $838 thousand for quarter one 2019. In addition, the Company continues to recognize the impact of its financial crisis losses in the form of deferred tax benefits that increase earnings and capital formation.

Numerous initiatives were undertaken by the board and management during 2018 to improve profitability and generate greater shareholder returns. These activities are reflected in the results discussed above, and are more fully discussed in the 2018 Letter to Shareholders located on the Company's website at floridacapitalbank.com. First quarter earnings were driven by an improved mortgage market, strong production and balance growth in warehouse lending, and significant growth in non-interest bearing deposits generated by the specialty banking line of business.

Mortgage Line of Business

Headwinds remain in the mortgage market as margins have improved somewhat, but remain compressed relative to historical levels. Early in the year, market participants anticipated an 11% decline in mortgage originations for 2019. As a result, the bank projected $637 million of 2019 mortgage production, which is a 15% decline from the $747 million of production reported in 2018. For the first quarter of 2019, total production was $139 million compared to a budgeted level of $172 million; however, both April ($57 million actual) and May ($75 million projected) production levels exceeded budget and eliminated the unfavorable year-to-date variance. A continued decline in long-term rates back to 2016 levels has improved refinance activity and stimulated more production. From a pricing perspective, the margin of 1.85% significantly exceeded the budgeted margin of 1.33% for the first quarter, and is substantially ahead of the 1.38% margin reported in 2018. The combination of these volume and pricing variances combined to generate mortgage gain on sale of $2.57 million, which was $272 thousand or 12% ahead of budget for the first quarter. Management continues to study staffing levels, the relative mix of fixed and variable costs, and overhead costs with a view toward recognizing opportunities to improve profitability.

Warehouse Line of Business

Warehouse lending reported total production in quarter one 2019 of $712 million. This level compares very favorably to first quarter 2019 budgeted production of $533 million and first quarter 2018 actual production of $534 million. During April and May of 2019 production levels approximated $350 million each month or in excess of $4 billion on an annual basis. As a result, average loan balances have substantially exceeded budget in the first quarter of 2019 – actual of $113 million versus budget of $65 million - and are more than twice the level of the $53 million reported in the first quarter of 2018. Management estimates that each incremental $1.00 of interest income and fees generates a net profit contribution of $0.64 for this business line. Gross committed facilities are approximately $300 million, and utilization rates have recently averaged between 45% - 50%.

Government Guaranteed Lending (GGL)

This business line continues to focus on originations and secondary market activities associated with SBA and USDA-guaranteed lending opportunities. First quarter profitability for this business line has lagged budget, and as result, secondary market gains on sale have been less than budgeted for 2019 and less than actual for 2018. This variance reflects the impact of the U.S. government shut-down in the first quarter of 2019, which had a rippling effect throughout the government guaranteed loans sector of the economy as loan closings were delayed and pipelines began to swell with delayed originations. The other factor that contributed to lower 2019 production relates to a continuation of the internal restructuring of this business line. Management has determined that this business line will consist of two channels. The first is a "direct to backroom" approach for smaller balance SBA 7(a) originations, which uses referral sources to generate originations that are managed in the bank's credit administration area. The bank will also continue to originate larger balance SBA and USDA-guaranteed loan relationships. During 2018, the owner of one of the bank's USDA-guaranteed relationships was named 2019 Small Business Person of the Year by the U.S. Small Business Administration. Management continues to explore the wide variety of GGL products available in the marketplace, and seeks to be a significant provider of credit to small businesses nationwide.

Specialty Banking

Specialty banking is comprised of fee-based ACH third party payment processing, money service business relationships that require cash handling, and a deposit generating, card-based program. Management has decided to exit the money service business, and continues to explore other attractive opportunities to raise low cost, long-term deposits. Specialty banking non-interest bearing deposits peaked at about $100 million during the first quarter of 2019 due to the seasonal nature of the card-based programs. As of March 31, 2019 specialty banking held $79 million of low cost deposits (approximate cost of funds is 7 basis points), and continues to be a strategic source of very low cost funding for both the mortgage and warehouse lines of business. For the first quarter of 2019, the bank's core deposits exceeded budget by $63 million, which allowed the bank to reduce its reliance on wholesale funding ($37 million less than budgeted) and lowered its cost of funds by 10 basis points less than budgeted. Continued growth in specialty banking deposits has enabled the bank to fund mortgage-related originations at a significantly lower cost of funds and improve earnings.

Community Bank

Management's decision to increase deposit rates during early 2018 as market rates increased has stabilized branch deposits and for the first time in a number of years branch deposit growth has begun to trend upward. At the same time, traditional community bank commercial lending – primarily real estate focused - continues in the bank's target markets. From a strategic perspective, the four major markets (Jacksonville, Orlando, Tampa and Gainesville) provide a source of lower cost deposits to fund commercial loan growth and mortgage operations. There continue to be legacy loans and deposits associated with a number of closed branch locations that are expected to disintermediate over time. Current efforts are focused on replacing these lost relationships with new customers in the remaining market areas.

Balance Sheet

Total assets of $433 million at the end of the first quarter of 2019 were $27 million or 7% greater than the $406 million reported at the end of 2018, and substantially exceeded the $366 million reported for quarter one 2018. For both comparative periods, the asset growth was centered in the loan portfolio, which increased $23 million compared to year-end 2018, and was $61 million greater than the reported amount at March 31, 2018. Within the loan portfolio, warehouse loans increased from $53 million to $113 million from March 31, 2018 to the same period in 2019, and rose $24 million compared to year-end 2018. The previously noted trend of declining commercial lending balances stabilized during the first quarter of 2019, and these balances increased $7 million or 6% during the first quarter.

Deposit growth continued during the first quarter of 2019 as total deposits increased $57 million or 24% compared to year end 2018, and $34 million or 13% compared to March 31, 2018. As noted above, the majority of this growth occurred in the specialty banking line of business, which is reflected in the growth of non-interest bearing deposits. For quarter one 2019, non-interest bearing deposits increased $32 million or 37% compared to year-end 2018, and were $49 million or 71% higher compared to the first quarter of 2018. From a budget perspective, quarter one 2019 total deposits (excluding brokered deposits) were $21 million or 10% in excess of budget.

Other borrowings were $95 million at March 31, 2019 compared to $127 million at the end of 2018 and $70M at March 31, 2018. Growth in specialty banking deposits has allowed the bank to reduce its Federal Home Loan Bank advances substantially, which averaged only $47 million during the first quarter of 2019 versus $68 million for 2018. The net impact of wholesale funding reflected offsetting variances as growth in specialty banking deposits reduced wholesale funding needs – and lowered the cost of funds; however, the increased warehouse lending experienced recently required incremental wholesale funding – but generated a higher level of interest income. Effectively, low cost specialty banking deposits are now funding a portion of the increase in mortgage-related lending, and reducing 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 first quarter of 2019, net interest income was $3.2 million, which was a $400 thousand or 14% improvement compared to the first quarter of 2018. For quarter one 2019, interest income increased $600 thousand or 16% to $4.3 million compared to the $3.7 million recorded in the first quarter of 2018. Higher interest income from warehouse lending contributed approximately $400 thousand of this increase. For the same period, interest expense rose $200 thousand or 22% to $1.2 million with the majority of the increase from higher interest cost on deposits. For the same period, non-interest income declined $200 thousand or 5% primarily due to lower GGL gains on sale, and non-interest expenses decreased $700 thousand or 9% ($2.8 million on an annualized basis), reflecting the staffing and expense reductions in 2018.

Florida Capital Group, Inc. and Subsidiary
Consolidated Statements of Financial Condition
(Unaudited March 31, 2019 and March 31, 2018 - Audited December 31, 2018)

	Unaudited March 31, 2019	Unaudited March 31, 2018	Audited December 31, 2018
Assets:			
Cash and due from banks	$ 8,160,342	$ 9,552,844	$ 9,077,903
Interest-bearing deposits in banks	22,310,433	16,354,419	15,539,877
Cash and cash equivalents	30,470,775	25,907,263	24,617,780
Securities available for sale	26,609,281	25,911,579	27,038,291
Restricted equity securities, at cost	5,308,741	4,242,800	5,661,741
Loans receivable, net of allowance for loan losses of $2,003,374 at March 31, 2019, $2,007,472 at March 31, 2018 and $1,956,613 in 2018	303,038,708	243,832,220	270,007,044
Loans held for sale	42,704,548	41,394,396	52,197,104
Accrued interest receivable	1,257,443	867,464	1,215,632
Foreclosed real estate	3,362,985	2,672,460	3,703,158
Premises and equipment, net	567,930	1,880,358	572,076
Cash surrender value of life insurance	10,621,347	10,371,038	10,559,325
Loan servicing rights	1,932,940	1,999,324	1,975,602
Deferred tax asset, net	4,600,170	-	4,600,170
Other assets	2,742,546	6,590,867	3,927,656
Total Assets	$ 433,217,414	$ 365,669,769	$ 406,075,579
Liabilities:			
Noninterest-bearing demand deposits	$ 118,011,813	$ 69,111,458	$ 86,062,135
Interest-bearing demand deposits	16,159,800	17,035,565	16,169,168
Money market and savings deposits	72,061,234	78,285,191	56,255,437
Time deposits	90,995,035	98,106,753	81,062,111
Total Deposits	297,227,882	262,538,967	239,548,851
Federal Home Loan Bank advances	94,000,000	69,300,000	102,000,000
Fed funds purchased	-	-	24,000,000
Repurchase agreements	1,161,068	299,075	1,472,021
Notes payable	150,000	-	150,000
Accrued interest payable	363,064	262,551	420,441
Accrued expense and other liabilities	3,115,137	2,713,219	2,006,931
Total Liabilities	396,017,151	335,113,812	369,598,244
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	2,791,060
Common stock, $.01 par value; 617,113,408 shares authorized, and 617,030,226 issued in 2019 and 2018	6,170,303	6,170,302	6,170,303
Additional paid-in capital	170,053,745	170,053,746	170,053,745
Accumulated deficit	(141,314,773)	(147,634,526)	(141,838,540)
Treasury stock, 375,763 shares at cost in 2019 and 2018, respectively	(1,809)	(1,648)	(3,191)
Accumulated other comprehensive loss	(498,263)	(822,977)	(696,042)
Total Stockholders' Equity	37,200,263	30,555,957	36,477,335
Total Liabilities & Stockholders' Equity	$ 433,217,414	$ 365,669,769	$ 406,075,579

In the opinion of management, the March 31, 2019 and 2018 unaudited condensed financial statements have been prepared on the same basis as the audited financial statements for the year ended December 31, 2018, and include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the Company's financial position at March 31, 2019 and 2018, and statements of operations for the three months ended March 31, 2019 and 2018. Certain amounts have not been reclassified to conform to the presentation format of the audited financial statements; however, in the opinion of management these reclassifications are not material to the fair presentation of the financial statements.

Florida Capital Group, Inc. and Subsidiary
Consolidated Statements of Income
(Unaudited March 31, 2019 and March 31, 2018 - Audited December 31, 2018)

	Unaudited Period Ended March 31, 2019	Unaudited For The Period Ended March 31, 2018	Audited Year Ended December 31, 2018
INTEREST INCOME:			
Loans receivable and fees on loans	$ 3,944,393	$ 3,488,104	$ 14,709,846
Investment securities	191,185	110,525	554,131
Interest-bearing deposits in banks	161,517	100,388	492,453
Total interest income	4,297,095	3,699,017	15,756,430
INTEREST EXPENSE:			
Deposits	666,474	489,277	2,285,663
Other	461,956	434,047	2,060,567
Total interest expense	1,128,430	923,324	4,346,230
NET INTEREST INCOME	3,168,665	2,775,693	11,410,200
PROVISION FOR LOAN LOSSES	150,000	0	0
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	3,018,665	2,775,693	11,410,200
NONINTEREST INCOME:			
Service charges on deposit accounts	66,844	73,913	648,161
Mortgage banking income	Incl in Other income	Incl in Other income	13,825,851
Gain on sale of SBA Loans	Incl in Other income	Incl in Other income	1,626,398
Other income	3,979,343	4,206,605	2,319,943
Total noninterest income	4,046,187	4,280,518	18,420,353
NONINTEREST EXPENSE:			
Salaries and employee benefits	4,152,736	4,714,586	18,878,618
Occupancy and equipment expense	391,793	381,558	1,461,874
Data processing, communications and telephone	423,107	433,732	2,571,803
Loan related expense	Incl in Other expense	Incl in Other expense	220,646
Foreclosed real estate expense	Incl in Other expense	Incl in Other expense	359,290
Mortgage banking related expense	Incl in Other expense	Incl in Other expense	1,294,309
Regulatory fees	78,088	102,064	357,107
Professional fees	Incl in Other expense	Incl in Other expense	896,026
Marketing expense	Incl in Other expense	Incl in Other expense	1,128,545
Other expenses	1,493,865	1,569,756	1,614,460
Total noninterest expense	6,539,589	7,201,696	28,782,678
Income Before Income Taxes	525,263	(145,485)	1,047,875
Income Taxes	-	2,456	-
Net Income	$ 525,263	$ (147,941)	$ 1,047,875

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