

Fine Tune EPS & Maintain Outperform; Excess Liquidity Supports Significant Loan Growth

Maintaining “Outperform” rating and Price Target to \$12.50 which equates to ~14.5x 2015 EPS, 120% of Tangible Book Value or a low 3.0% Core Deposit Premium.

Trimming 2015 EPS by a nickel to \$0.86 primarily to reflect slightly lower NIM. Establishing 2016 EPS at \$0.94. Our EPS forecast calls for a ROAA of ~0.70% in 2015.

Loan growth continues to be a challenge and will remain an area of intense focus in 2015. Management tweaked its loan pricing in mid-2014 to become more competitive in an effort to deploy excess liquidity. This move spurred increased production as 2H14 originations increased 16% over 1H14 levels. However, payoffs have remained elevated masking favorable trends. We are forecasting mid-single digit loan growth in 2015 as management gains greater traction in the Augusta, GA and Columbia, SC markets. No additional headcount is needed to achieve growth though changes among the existing lending ranks is possible as underperformers are replaced.

The recent deposit acquisition (Sept. 30th) negatively impacted NIM in 4Q14 which appears to have bottomed in the near term. Looking forward, modest expansion is forecast as securities are shifted into loans and FCCO benefits from its recent FHLB prepayment. Our 2015 outlook calls for minimal growth in Average Earning Assets and ~5% growth in Net Interest Income stemming from a more favorable earning asset mix. A risk to our NIM forecast is increased prepayments of securities if long term rates stay down, which would increase amortization and result in lower bond yields and in turn a lower NIM.

No significant changes to our 2015 Fee Income or Operating Expense forecast. Core fee income is projected to expand ~7% aided primarily by growth in mortgage related revenues. Wealth management fees are expected to be flattish Y-O-Y following a significant spike in fees in 4Q14.

Core Operating expenses are forecast to increase ~4-5% reflecting normal cost of living adjustments, increased mortgage activity, a full year impact of Savannah River deal partially offset by lower credit/OREO related expense. Core expenses should approximate ~2.9-3.0% of average assets while little change in the core Efficiency ratio of ~70% is expected.

Loan loss provisioning is forecast to slightly exceed NCOs in 2015 such that reserve coverage holds flattish given our mid-single digit loan growth forecast.

Management expects to enter into a “Consent” order with the FDIC due to a weakness in the banks compliance with the Bank Secrecy Act (BSA). This was a temporary issue due to unexpected employee turnover and requirements in the proposed final order have already been addressed and rectified by the bank and are not expected to result in any additional expense or distraction prospectively. In our view, the earliest termination of the Consent order is one exam cycle which could suggest sometime in 1H16. While this order is likely to restrict/prevent additional M&A in the near term, it does not overshadow the company’s long history of compliance with BSA or the significant positive initiatives that occurred in 2014 including the Savannah River Acquisition, the opening of de novo branch in downtown Columbia, SC, and the purchase and assumption deal with First South Bank. And more recently, the announced 16% increase of the common dividend to \$0.07 per share and the planned opening of its Blythewood, SC office in Spring 2015.

4Q14 EPS Review

FCCO reported 4Q14 EPS of \$0.22. Excluding net non-recurring expense of \$233,000 we peg Core EPS at \$0.24, two cents better than expected. Greater than expected fee income more than offset slightly higher expenses leading to the upside relative to our estimate. Common dividend was increased nearly 17% to \$0.07 per share. Additionally, management announced it expects to enter into a "Consent" order with the FDIC due to a weakness in the banks compliance with the Bank Secrecy Act (BSA).

Lack of net loan growth was mitigated by favorable trends in fee income, low credit costs and prudent expense management. NIM weakness stemmed from the recent acquisition of deposits.

Nonrecurring items in the quarter included \$284,000 in prepayment penalties on FHLB advance, \$29,000 in merger related costs partially offset by \$80,000 in securities gains.

Prepayment of \$3.5 Mil. in FHLB advances with a weighted average cost of ~4% is expected to result in annual interest expense savings of \$140,000 or a penny per share.

Core revenues expanded 1.85% linked quarter and were augmented by a 1.6% decline in core operating expense leading to improved operating leverage underscored by a 292 bps decline in the Core Efficiency ratio to 66.2%. Core expenses represent 2.8% of average assets.

Core Revenues benefitted from solid growth in both Spread and Fee Income. Net Interest Income expanded 1.5% as volume growth in average earning assets more than offset NIM shrinkage. Core fee income grew 2.5% as a sharp jump in Investment income more than offset a seasonal decline in mortgage revenues (-16%).

NIM declined 5 bps linked quarter primarily due to a negative mix shift in earning assets as deposits acquired were invested in short term investments/bonds as loan demand remained weak. This was exacerbated by continued pressure on loan yields which declined 6 bps to 4.96%. A further reduction in Cost of Funds provided some offset.

Loan balances declined \$4.7 Mil. linked quarter as payoffs continued to offset new originations. This trend has been ongoing in 2014 as full year loan production increased 33% in 2014 to \$80 Mil. However, this was not enough to offset payoffs of \$99 Mil.

Deposits declined \$17 Mil. or 2.5% with much of the drop housed in Pure deposits which held steady on a relative basis at 75% of deposits. This decline reflects normal seasonal trends with balances rebounding early in 2015.

Credits Quality remains healthy underscored by a 12% decline in Classified Assets, a 3% decline in NPAs (ex TDRs) to 2.13% of loans & OREO, and annualized NCOs of 18 bps. Provisioning essentially matched NCOs holding reserve coverage of loans stable at 0.93% of loans or a stronger 1.33% inclusive of loan discounts.