Introduction

Coastal Banking Company, Inc. (the "Company") is the $562.6 million-asset bank holding company of CBC National Bank (the "Bank"), headquartered in Fernandina Beach, Fla., which provides a full range of consumer and business banking services through full-service banking offices in Fernandina Beach, Ocala, and The Villages, Fla, and Beaufort and Port Royal, S.C. The company's residential mortgage banking division, headquartered in Atlanta, includes traditional retail and wholesale lending, as well as a national retail group that has lending offices in Florida, Georgia, Maryland, North Carolina, Illinois, Ohio and Tennessee. The company's SBA lending division originates SBA loans primarily in Jacksonville, Ft. Myers, Tampa and Vero Beach, Fla., Greensboro, N.C., Atlanta, and Beaufort.

The company's common stock is publicly traded on the OTCQX Best Market under the symbol CBCO. The company was named to the OTCQX® Best 50 in both 2015 and 2016, an annual ranking of the top 50 U.S. and international companies traded on the OTCQX Best Market, based on equal weighting of one-year return and average daily dollar volume growth.
A current CBCO stock price quote and recent stock trading activity is available at:

http://www.otcmarkets.com/stock/CBCO/quote

On May 2, 2012 the Company filed a Form 15-12G with the Securities and Exchange Commission (the "SEC") to terminate the registration of its common stock under Section 12(G) of the Securities Exchange Act of 1934 and thereby suspend its duty to file reports with the SEC under Sections 13 and 15(D) of the Act. As a result, the Form 10Q filed for the period ended March 31, 2012 is the final financial report filed with the SEC by the Company. Related to the report below, Management intends to continue to prepare and publish quarterly interim and annual financial reports with similar information as previously reported to the SEC to ensure investors have access to timely, meaningful information related to the Company's results. These financial reports will be published on the Company's website at intervals consistent with the comparable SEC filing deadlines.

On January 22, 2016 the Company filed a Regulation A Offering Statement on Form 1-A with the SEC for the purpose of qualifying the common shares to be issued in connection with the acquisition of First Avenue National Bank (see below). Amendments to this filing were submitted to the SEC on February 23, 2016 and February 25, 2016. The SEC issued a notice of qualification of the filing on February 29, 2016. After filing Form 1-Z of Regulation A on May 9, 2016, our duty to file reports with the SEC under Sections 13 and 15(D) of the Act was again suspended.

On April 8, 2016, the Company completed its acquisition of First Avenue National Bank. ("FANB"), a $112 million bank headquartered in Ocala, Florida. At that time, FANB merged with and into the Bank. The acquisition expanded the Company's Florida market presence, as FANB had a total of three full-service branches located in Ocala and The Villages, Florida.

A more complete history of Coastal Banking Company, Inc. (the "Company") may be found at the Company's website at:

http://www.coastalbanking.com/about-us.html

Forward-Looking Statements

This report contains "forward-looking statements" relating to, without limitation, future economic performance, plans and objectives of management for future operations, and projections of revenues and other financial items that are based on the opinions of management, as well as assumptions made by and information currently available to management. The words "may," "will," "anticipate," "should," "would," "believe," "contemplate," "expect," "estimate," "continue," "may," and "intend," as well as other similar words and expressions of the future, are intended to identify forward-looking statements.

Results of Operations

The following discussion describes our results of operations for the first quarter ended March 31, 2017 as compared to the first quarter ended March 31, 2016, and also analyzes our financial condition as of March 31, 2017 as compared to March 31, 2016 and December 31, 2016. Like most community banks, we derive a significant portion of our income from interest we receive on our loans and investments. Our primary sources of funds for making these loans and investments are our deposits and borrowings, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets and the expense on our interest-bearing liabilities. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities.

There are risks inherent in all loans, so we maintain an allowance for loan losses to absorb possible losses on existing loans that may become uncollectible. We establish and maintain this allowance by charging a provision for loan losses against our operating earnings. Please see the section entitled "Provision and Allowance for Loan Losses" for additional detail.

In addition to earning interest on our loans and investments, we earn income through gains on sales of loans, service charges, fees, cash surrender value of life insurance and other income. The Company's more significant sources of revenue are from Gain on Sale of Mortgage Loans and SBA Loan Income as discussed in the sections entitled "Mortgage Banking Operations" and "SBA Lending". We describe these gains and the other various components of noninterest income, as well as our noninterest expense, in the sections entitled "Noninterest Income" and "Noninterest Expense."

The following discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the accompanying financial statements. We encourage you to read this discussion and analysis in conjunction with the financial statements and the related notes and the other statistical information also included in this report.

Overview

Net income for the three months ended March 31, 2017 was $1,448,000 or $0.38 per diluted common share, compared to net income of $1,218,000, or $0.44 per diluted common share for the first three months of 2016. Net income per basic common share was $0.40 for the first quarter of 2017, compared to $0.45 for the first quarter of 2016. Net income increased 18.9% from the first quarter last year to the first quarter this year. The decline in diluted and basic income per common share is due to the shares issued for the First Avenue National Bank acquisition in April, 2016 as discussed above.

Net interest income was $5,108,000 for the quarter ended March 31, 2017 compared to net interest income of $3,940,000 for the quarter ended March 31, 2016, a year over year increase of 29.6%. The Company's net interest margin increased from 3.89% for 2016 to 4.05% for 2017.

The provision for loan losses for the three months ended March 31, 2017 was $295,000 compared to $33,000 for the three months ended March 31, 2016. The year over year increase to the provision for loan losses reflects the growth in the balance of portfolio loans, particularly from the increase in loans from our acquisition of First Avenue Bank ("FANB") in April of 2016. The provision for loan losses recorded each year reflects the amount calculated by our allowance for loan losses methodology, which also takes into account current economic conditions, loan quality measures and the underlying collateral value securing many of our loans.

Noninterest income for the first quarter of 2017 totaled $4,771,000 representing a $1,075,000, or 29.1% increase from the $3,696,000 for the first quarter of 2016. This increase was driven primarily by a higher level of mortgage banking noninterest income at $3,408,000, a year over year increase of $479,000 from $2,929,000 for last year's first quarter, which was supplemented by a $445,000 increase in SBA loan noninterest income from 580,000 in the first quarter of 2016 to $1,025,000 for the first quarter of 2017. The increase in mortgage banking income was driven by increased margins on loan sales year over year. Residential mortgage loans sold totaled $346.6 million in the first quarter of 2017 compared to $379.7 million in the first quarter of 2016. The year over year increase in SBA loan income reflects increased selling volume in 2017 of the guaranteed portion of SBA loans. A total of $8.9 million of SBA loans were sold during the first quarter of 2017 compared to $4.5 million of SBA loans sold during the first quarter or 2016. Service charges on deposit accounts, other service charges, commissions and fees and other income all increased in 2017 over 2016 in part due to the addition of FANB.

Noninterest expenses in the first quarter of 2017 were $7,226,000, a 27.3% increase over the $5,677,000 in the first quarter of 2016, primarily as a result of the acquisition of FANB as noted above. The largest contributor to this increase was salaries and benefits, which increased by $1,019,000 or 28.3%. Various other noninterest expenses also increased primarily as a result of the addition from the three FANB branches and their related operating costs. The Company's efficiency ratio, which is a measure of total noninterest expenses as a percentage of net interest income and noninterest income, declined slightly from 74.34% in 2016 to 73.15% in 2017.

For the three months ended March 31, 2017 we incurred an income tax expense of $910,000 compared to $708,000 for the three months ended March 31, 2016. Our effective tax rate was 38.6% in 2017 and 36.8% in 2016. The current year increase in effective tax rate reflects a slightly higher percentage of growth in taxable income in 2017 over 2016.

Supplemental Segment Information

The Bank has three reportable business segments: Community Banking, SBA Lending, and Mortgage Banking Operations.
All direct costs and revenues generated by each business segment are allocated to the segment; however, there is no allocation of indirect corporate overhead costs to the SBA Lending or Mortgage Banking segments. Additionally, interest expense is allocated to the SBA Lending and Mortgage Banking segments based on the Bank's monthly average cost of funds plus 1.50%. The Bank's reportable business segments are strategic business units that offer different products and services to a different customer base.

(In thousands)	Community Banking		SBA Lending Operations		Mortgage Banking Operations	
Three months ended March 31,	2017	2016	2017	2016	2017	2016
Interest income	$ 3,484	$ 2,093	$ 1,455	$ 1,075	$ 1,129	$ 1,367
Interest expense	573	287	536	413	571	680
Net interest income	2,911	1,806	919	662	558	687
Provision for loan losses	153	1	53	-	89	32
Net interest income after provision	2,758	1,805	866	662	469	655
Non-interest income	173	131	1,049	580	3,358	2,893
Non-interest expense	1,588	1,064	861	657	2,878	2,321
Net income before tax expense	1,343	872	1,054	585	949	1,227
Income tax expense (benefit)	531	344	416	231	375	467
Net income (loss)	$ 812	$ 528	$ 638	$ 354	$ 574	$ 760

Mortgage Banking Operations

The Bank has operated a residential mortgage lending division headquartered in Atlanta, Georgia since September 2007. The division originates and funds residential mortgage loans submitted by mortgage brokers, as well as loan applications submitted directly from borrowers, and then sells these mortgage loans into the secondary market. We expanded this division in 2011 by opening retail residential loan production offices throughout the country. This new group is known as our National Retail Group (NRG). As of December 31, 2016, the mortgage banking division operates 12 retail residential loan production offices in the 7 states of Florida, Georgia, Illinois, Maryland, North Carolina, Tennessee and Ohio. This lending channel subjects us to various risks, including credit, liquidity, and interest rate risks. We reduce credit and liquidity risks by selling virtually all the mortgage loans originated through this division. From time to time, we may decide to hold loans originated through this division as additions to our residential real estate loan portfolio. We determine whether the loans will be held in our portfolio or sold in the secondary market at the time of origination. We may also subsequently change our intent to hold loans in portfolio and subsequently sell some or all of these loans from our portfolio as part of our corporate asset/liability management strategy.

As part of our mortgage banking activities, we enter into commitments to fund residential mortgage loans by a specified future date. A mortgage loan commitment is an interest rate lock that binds us to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock, subject to the loan applicant satisfying the underwriting conditions required for approval of their loan application. These loan commitments are derivative loan commitments and the loans that result upon exercise of the loan commitments are held for sale. These derivative loan commitments are recognized at fair value in the balance sheet with changes in fair value recorded as part of mortgage banking noninterest income. We record no value for the loan commitment at inception. Subsequent to inception, however, we recognize the fair value of the derivative loan commitment based upon (i) estimated changes in the fair value of the underlying loan that would result from the exercise of that commitment and (ii) changes in the probability that the underlying loan will fund within the terms of the commitment (referred to as the "pull through" rate). The value of the underlying loan is affected primarily by changes in interest rates and the passage of time.

Outstanding derivative loan commitments expose us to the risk that the value of the loans underlying the commitments might decline due to increases in mortgage interest rates from the date of the inception of the rate lock to the funding of the loan. The Company's closed inventory and locked pipeline shall be hedged with instruments that present the lowest possible Beta risk to the Company. Hedges include, but are not limited to: FNMA, FHLMC and GNMA I and II Mortgage Backed Securities, cash commitments, and mandatory commitments to investors.

The Mortgage segment's net income declined slightly from $760,000 for the first quarter of 2016 to $574,000 for the first quarter of 2017. The primary source of direct income generated by this division is the gain on sale of mortgage loans which is part of non-interest income. Non-interest income was $3,358,000 for the three months ended March 31, 2017 compared to $2,893,000 for the three months ended March 31, 2016, an increase of 16.1%. Although the volume of loans originated and sold declined from the first quarter of 2016 to the first quarter of 2017 as mentioned above, the Mortgage Division's strategy of increasing its mix of government backed loans resulted in higher yields and increased Gain on Sale income this year. The direct noninterest expenses incurred by the division were $2,878,000 during the first three months of 2017, a 24.0% increase over the first quarter 2016 expenses of $2,321,000. Salaries and benefits and other expense increases were the primary reasons for the year over year change for the first quarter.

Beginning in the fourth quarter of 2016, the Company changed its financial statement presentation to reclassify the direct lending costs incurred by its Mortgage Segment's National Retail Group (NRG) against that group's origination income. This change only affects reported noninterest income and noninterest expense, and provides for a better reflection of the Company's efficiency ratio. The Company's financials for the first quarter of 2016 were restated for this change for comparability purposes. This change had no effect on the Company's reported net income for the three months ended March 31, 2017 or 2016. Income and expense discussed above includes this change as well.

SBA Lending

SBA Lending has been a part of the Company's banking operations since 1999. Headquartered in Fernandina Beach, Florida, SBA operations were expanded in April 2010, including government guaranteed loan originations throughout the southeastern United States. Loans are generated by experienced, lending professionals through 7 SBA offices with loan administration, including approval, centralized in Fernandina Beach. Income from the division is generated through premiums on sale and servicing income of the guaranteed amounts, typically 75% of the loan. The SBA segment's net income grew from $354,000 for the first quarter of 2016 to $638,000 for the first quarter of 2017. SBA noninterest income for the three months ended March 31, 2017 totaled $1,049,000, up 80.9% from $580,000 during the first three months of 2016. SBA Lending's expenses only increased from $657,000 in the first quarter of 2016 to $861,000 in the first quarter of 2017, primarily in Salaries and benefits. Strategically, the division continues to retain the majority of production. The overall SBA loan portfolio increased from $84.6 million at March 31, 2016 to $92.8 million at March 31, 2017. Retaining the guaranteed amounts provides increased interest income while maintaining the ability to create potential non-interest income through participation sales at a future date. The portion of the SBA portfolio available for sale at December 31, 2016 stood at $37.1 million. During the first quarter of 2017, SBA Lending originated $10.3 million in loans, sold $8.9 million, and grew the available for sale portfolio to $41.8 million. The Company elected to sell a greater percentage of its originations during the first quarter of 2017, based on the cyclical nature of its other bank operating segments. This hold versus sale strategy remains a crucial part of management's plan moving forward.

Community Banking

At the end of 2015, the Bank had 3 branches in Fernandina Beach, Florida, and Beaufort and Port Royal, South Carolina. With the acquisition of First Avenue Bank, 3 additional branches were added in April, 2016 in the Ocala, Florida area. The acquisition significantly increased the magnitude and importance of this segment to the Company. The primary source of income generated by this division is interest and fees on loans, service charges and other income from typical retail banking sources. Net income for Community Banking increased from $528,000 in the first quarter of 2016 to $812,000 for the first quarter of 2017. Net interest income increased 61.2%, noninterest income increased 32.1%, partially offset by an increase of 49.2% from the first quarter of 2016 to the same period in 2017 primarily as a result of the addition of FANB that occurred in April, 2016. The increased net income from the Community Banking segment has significantly contributed to the more balanced operating results between the Company's three key operating segments.

Net Interest Income

For the first three months ended March 31, 2017 net interest income totaled $5,108,000, up by 29.6% from $3,940,000 for the first three months in 2016. This increase to net interest income was largely driven by a 25.8% increase in the average balance of earning assets, offset by a 23.7% increase in interest bearing liabilities. Interest income from loans, including fees, increased 29.0% to $5,816,000 for the quarter ended March 31, 2017 compared to the same period last year. The average balance of loans was $467.5 million in the first quarter of 2017 compared to $378.0 million during the first quarter of 2016, for a year over year rise of 23.7%. These increases were all attributable to the addition of FANB and growth in portfolio loans. The weighted average rate earned on loans increased 20 basis points to 5.04% for the first three months of 2017 from the first quarter of 2016. This increase was due to the two recent prime rate increases. The favorable impact of the year over year increase to interest income was slightly offset by a corresponding increase in the amount of interest expense, which totaled $959,000 for the quarter ended March 31, 2017, compared to $767,000 for the quarter ended March 31, 2016. The net interest margin was 4.05% for the quarter ended March 31, 2017 and 3.89% for the quarter ended March 31, 2016.

Average Balances and Interest Rates

The table below shows the average balance outstanding for each category of interest-earning assets and interest-bearing liabilities for the first quarter of 2017 and 2016, and the average rate of interest earned or paid thereon. Average balances have been derived from the daily balances throughout the period indicated. Non-accrual loans and the interest income recorded on these loans, if any, are included in the yield calculation for loans in all periods reported. Amounts are presented on a tax equivalent basis.

	2017			2016		
(In thousands)	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Assets:						
Interest-earning assets:						
Loans	$ 467,476	$ 5,816	5.04%	$ 377,986	$ 4,508	4.84%
Taxable investments	24,255	169	2.83%	24,350	168	2.79%
Tax-free investments	4,701	53	4.60%	3,432	43	5.06%
Interest-bearing deposits in other banks	379	1	1.14%	362	1	0.79%
Federal funds sold	14,667	44	1.23%	456	1	0.89%
Total interest-earning assets	511,478	6,083	4.82%	406,586	4,721	4.71%
Other noninterest earning assets	31,598			22,830		
Total assets	$ 543,076			$ 429,416		
Liabilities and shareholders' equity:						
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand and savings deposits	$ 270,028	$ 247	0.37%	$ 171,228	$ 128	0.30%
Time deposits	152,228	430	1.15%	123,640	284	0.93%
Other borrowings	57,371	282	1.99%	92,791	355	1.55%
Total interest-bearing liabilities	479,628	959	0.81%	387,659	767	0.80%
Other noninterest bearing liabilities	10,834			7,750		
Shareholders' equity	52,614			34,007		
Total liabilities and shareholders' equity	$ 543,076			$ 429,416		
Excess of interest-earning assets over interest bearing liabilities	$ 31,850			$ 18,927		
Ratio of interest-earning assets to interest-bearing liabilities	107%			105%		
Tax equivalent adjustment		(16)			(14)	
Net interest income		$ 5,108			$ 3,940	
Net interest spread			4.01%			3.91%
Net interest margin			4.05%			3.89%

Interest Rate Sensitivity and Asset Liability Management

Interest rate sensitivity measures the timing and magnitude of the repricing of assets compared with the repricing of liabilities and is an important part of asset/liability management of a financial institution. The objective of interest rate sensitivity management is to generate stable growth in net interest income, and to manage the risks associated with interest rate movements. Management constantly reviews interest rate risk exposure under various interest rate scenarios so that adjustments in interest rate sensitivity can be made on a timely basis. Net interest income is the primary component of recurring net income for financial institutions. Net interest income is affected by the timing and magnitude of repricing as well as the mix of interest sensitive and noninterest sensitive assets and liabilities. "Gap" is a static measurement of the difference between the contractual maturities or repricing dates of interest sensitive assets and interest sensitive liabilities for a given time period. The projected Gap exposure is expressed as a ratio of interest sensitive assets to interest sensitive liabilities in an attempt to predict the behavior of the Company's net interest income during periods of moving interest rates.

The following table summarizes the amounts of the Company's interest-earning assets and interest-bearing liabilities outstanding at March 31, 2017, that are expected to mature, prepay, or reprice in each of the future time periods shown. Except as stated below, the amount of assets or liabilities that mature or reprice during a particular period was determined in accordance with the contractual terms of the asset or liability. Adjustable rate loans are included in the period in which interest rates are next scheduled to adjust rather than in the period in which they are due, and fixed-rate loans and mortgage-backed securities are included in the periods in which they are anticipated to be repaid based on maturities. The Bank's savings accounts and interest-bearing demand accounts (NOW and money market deposit accounts) that are not contractually tied to an adjusting index are grouped into categories based on the Company's historical repricing practices. Money market accounts, which are contractually tied to repricing indexes, reprice monthly and are grouped in the three month or less category. Many of these money market accounts are tied to a Treasury index.

At March 31, 2017 Maturing or Repricing in:

(In Thousands)	3 Months or Less	4 Months to 12 Months	1 to 5 Years	Over 5 Years	Total
Mortgage-Backed Securities	$ 748,081	$ 2,895,771	$ 6,856,038	$ 5,552,901	$ 16,052,791
Fed Funds Sold	184,588				184,588
Other Investments	5,329,726	790,761	6,534,553	3,499,033	16,154,073
Total Investments	$ 6,262,395	$ 3,686,532	$ 13,390,591	$ 9,051,934	$ 32,391,452
Commercial Loans	$ 83,250,977	$ 1,757,968	$ 3,638,202	$ 2,699,187	$ 91,346,334
Real Estate Loans	196,632,548	65,864,817	65,206,049	28,847,565	356,550,979
Installment Loans	23,558,052	9,375,208	6,322,271	9,403,454	48,658,985
Total Loans	$ 303,441,577	$ 76,997,993	$ 75,166,522	$ 40,950,206	$ 496,556,298
Total Interest-Earning Assets	**$ 309,703,972**	**$ 80,684,525**	**$ 88,557,113**	**$ 50,002,140**	**$ 528,947,750**
Certificates of Deposit	$ 26,945,896	$ 80,118,964	$ 47,459,867	$	$ 154,524,727
Transaction & Savings	77,396,360	8,569,869	43,215,456	65,604,504	$ 194,786,189
Senior Debentures	7,217,000				7,217,000
Junior Subordinated Debentures	8,666,667				8,666,667
FHLB Advances	32,700,000	6,500,000	10,500,000		49,700,000
Total Interest-Bearing Liabilities	**$ 152,925,923**	**$ 95,188,833**	**$ 101,175,323**	**$ 65,604,504**	**$ 414,894,583**
Interest Sensitive Assets	$ 309,703,972	$ 80,684,525	$ 88,557,113	$ 50,002,140	$ 528,947,750
Interest Sensitive Liabilities	$ 152,925,923	$ 95,188,833	$ 101,175,323	$ 65,604,504	$ 414,894,583
Gap	$ 156,778,049	$ -14,504,308	$ -12,618,210	$ -15,602,364	$ 114,053,167
Cumulative Gap	**$ 156,778,049**	**$ 142,273,741**	**$ 129,655,531**	**$ 114,053,167**	
Gap Ratio	**2.03**	**0.85**	**0.88**	**0.76**	**1.27**
Cumulative Gap Ratio	**2.03**	**1.57**	**1.37**	**1.27**	
Cumulative Gap as % of EA	29.6%	26.9%	24.5%	21.6%	

At March 31, 2017, the Company, as measured by Gap, is asset sensitive with a cumulative projected Gap ratio of 2.03 over a three month period and a cumulative projected Gap ratio of 1.57 over a one year period. At March 31, 2017, the Company had $156.8 million more assets than liabilities repricing or maturing within three months, and $142.3 million more assets than liabilities repricing over a one-year time period. Generally, the Company's Gap ratios indicate that net interest income will increase if rates rise. However, Gap analysis does not take into account the potential decreased demand for Mortgage loans and other loans in an increasing interest rate environment that might reduce the Company's noninterest income (i.e. Gain on Sale income).

Management regularly evaluates its interest rate risk, including deposit pricing policies, loan demand, and changes in the mix of various types of interest bearing assets and liabilities. The Company forecasts its sensitivity to interest rate changes not less than quarterly using modeling software.

Provision and Allowance for Loan Losses

There are risks inherent in making all loans, including risks with respect to the period of time over which loans may be repaid, risks resulting from changes in economic and industry conditions, risks inherent in dealing with individual borrowers, and, in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral. We establish and maintain an allowance for loan losses based on a number of quantitative and qualitative factors including, among other things, historical experience, evaluation of economic conditions, regular reviews of delinquencies and loan portfolio quality and a number of assumptions about future events, which we believe to be reasonable, but which may not prove to be accurate. We believe that changes in economic and industry conditions capture the impact of general declines in the value of collateral property, and in this way our factors reflect general declines in collateral values.

The provision for loan losses is the periodic charge to operating earnings that management believes is necessary to maintain the allowance for possible loan losses at an adequate level. The amounts of these periodic charges are based on management's analysis of the potential risk in the loan portfolio. This analysis includes, among other things, evaluation of the trends in key loan portfolio metrics as follows:

(In thousands)	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016	March 31, 2016	December 31, 2015	September 30, 2015	June 30, 2015
Portfolio loans, gross	$ 403,082	$ 408,743	$ 398,686	$ 393,146	$ 298,262	285,933	$ 274,704	$ 272,115
Loans past due > 30 days and still accruing interest	$ 4,278	$ 989	$ 795	$ 4,177	$ 1,056	123	$ 2,302	$ 1,752
Loans on nonaccrual	$ 3,503	$ 6,070	$ 5,867	$ 4,478	$ 1,936	2,478	$ 3,484	$ 2,787
(as a % of loans, gross)	0.87%	1.49%	1.47%	1.14%	0.65%	0.87%	1.27%	1.08%
Net loan charge offs (recoveries)	$ 668	$ (70)	$ (56)	$ (29)	$ 869	16	$ 8	$ 21
(as a % of loans, gross)	0.17%	(0.02)%	(0.02)%	(0.01%)	0.29%	0.01%	0.00%	0.01%

"Portfolio loans, gross" addresses the impact on the provision for loan losses from changes in the size and composition of our loan portfolio. We apply various reserve factors to our portfolio based on historical levels and trends to establish various reserve percentages based on the relative inherent risk for a particular loan type and grade. The inherent risk is established based on peer group data, information from regulatory agencies, the experience of the Bank's lending officers, and recent trends in portfolio losses. These reserve factors are continuously evaluated and subject to change depending on trends in national and local economic conditions, the depth of experience of the Bank's lenders, delinquency trends and other factors. We have made an effort over the last several years to lower the risk profile of our loan portfolio. In doing so, the increase in our loan portfolio size over the last two years reflects a shift in composition from higher risk-rated real estate construction loans to comparably lower risk-rated owner occupied residential real estate loans. This has moderated to some degree the inherent risk in an expanding loan portfolio.

"Loans past due greater than 30 days and still accruing interest" has proven to be a useful leading indicator of directional trends in future loan losses. As the level of this metric rises, expectations are for a comparable increase in loans moving into a nonaccrual status and ultimately foreclosure resulting in increased losses. This pattern has been observed in the past where increases in loans past due greater than 30 days and still accruing are followed in future quarters with the same directional changes in the level of loans on nonaccrual. The level of loans past due greater than 30 days and still accruing interest totaled $4,278,000 at March 31, 2017, an increase from the $989,000 at December 31, 2016 and an increase from the $1,056,000 at March 31, 2016. While the long term trend in credit quality over the last several years has improved, we continue to experience ups and downs throughout the process and so management will continue to carefully monitor past due loans and work aggressively to manage loan delinquency levels.

"Loans on nonaccrual" has been another leading indicator of potential future losses from loans. We typically place loans on nonaccrual status when they become 90 days past due. In addition to the interest lost when a loan is placed on nonaccrual status, there is an increased probability of a loan on nonaccrual moving into foreclosure with a potential loss outcome. The March 31, 2017 nonaccrual loan balance decreased to $3,503,000, or 0.87% of loans compared to $6,070,000, or 1.49% of loans, at December 31, 2016, and $1,936,000 or 0.65% of loans, as of March 31, 2016. All of the ratios above exclude loans held for sale. Management intends to remain vigilant in our loan monitoring and loss mitigation efforts to either rehabilitate these credits or maximize recovery if required.

"Net loan charge offs or recoveries" reflect our practice of charging recognized losses to the allowance and adding subsequent recoveries back to the allowance. For the first quarter of 2017, net charges offs were $668,000, or 0.17% of loans, compared to net loan charge offs of $869,000, or 0.29% of loans, for the first quarter of 2016.

In addition to considering the metrics described above, we evaluate the collectability of individual loans, the balance of impaired loans, economic conditions that may affect the borrower's ability to repay, the amount and quality of collateral securing the loans and a review of specific problem loans. Based on this process and as shown below, the provision charged to expense was $295,000 for the quarter ended March 31, 2017, as compared to $33,000 for the first three months of 2016.

(In thousands)	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016	March 31, 2016	December 31, 2015	September 30, 2015	June 30, 2015
Provision during quarter ended	$ 295	$ 1,001	$ 56	$ 360	$ 33	$ 44	$ 57	$ 33
Provision added in excess of (less than) net charge-offs	$ (373)	$ 1,071	$ 112	$ 389	$ (836)	$ 28	$ 49	$ 12
Allowance for loan losses	$ 5,618	$ 5,991	$ 4,920	$ 4,808	$ 4,419	$ 5,254	$ 5,226	$ 5,177
(as a % of loans, gross)	1.39%	1.47%	1.23%	1.22%	1.48%	1.84%	1.90%	1.90%

As shown above, during the three months ended March 31, 2017 the allowance for loan losses declined slightly to a level of $5,618,000, or 1.39% of gross loans outstanding, as compared to $5,991,000, or 1.47% of gross loans outstanding at December 31, 2016. The decline in the allowance for loan losses percentage is consistent with the decline in loans on nonaccrual discussed above, and the overall decreased level of nonperforming assets since December 31, 2016. The Company's ratio of nonperforming assets to total assets has declined from 1.98% to 1.50% over that time period. The allowance for loan losses was $4,419,000, or 1.48% of loans, at March 31, 2016 prior to the FANB acquisition. These ratios of the allowance to loans excludes loans held for sale.

Management continues to carefully monitor past due and nonaccrual loans. Management acknowledges that future asset quality results may vary from our estimates and expectations, resulting in negative asset quality metrics, which could have a material adverse effect on our results of operations and financial condition.

Noninterest Income

Noninterest income was $4,771,000 for the quarter ended March 31, 2017, which was an increase of $1,075,000, or 29.1%, from $3,696,000 noninterest income earned during the quarter ended March 31, 2016. The largest factor in this year-over-year increase occurred in mortgage banking noninterest income, which was $3,408,000 for the three months ended March 31, 2017 compared to $2,929,000 for the three months ended March 31, 2016. This rise in mortgage banking income was driven by an increase in the yield earned on mortgages sold into the secondary market for the three month period. The increase in yield resulted from a strategic change in the mix of originations between government and conventional mortgages. The volume of mortgages sold for the three months ended March 31, 2017 declined to $346.6 million compared to $379.7 million the same period in 2016. The Mortgage noninterest income above for 2016 and 2015 again reflect the reclassification of the income and direct lending costs of the NRG as previously discussed. SBA loan noninterest income increased by 76.7% to $1,025,000 for the first quarter of 2017 compared to $580,000 for the first quarter of 2016. SBA loan participations sold into the secondary market increased from $4.5 million in the first quarter of 2016 to $8.9 million in the first quarter of 2017. The amount of SBA portfolio loans available for sale, the source of SBA's noninterest income, also increased from $37.1 million at December 31, 2016 to $41.8 million at March 31, 2017.

Service charges on deposit accounts increased by 22.3% over last year to $65,000 for the quarter ended March 31, 2017 due to the addition of three branches and related deposits acquired in the FANB acquisition. Other service charges, commissions and fees increased from $110,000 to $177,000 due to the addition of FANB. Other income increased year over year for the first quarter due to a $65,000 recovery of prior year expenses from a court ordered bankruptcy settlement in the bank's favor.

Noninterest Expense

Total noninterest expense for the three months ended March 31, 2017 was $7,226,000 as compared to $5,677,000 for the three months ended March 31, 2016. The year-over-year increase in noninterest expense of $1,549,000 reflects the new expenses associated with the acquired FANB operations subsequent to the acquisition in April, 2016. Noninterest expense associated with the three FANB branches totaled $715,000 in the first quarter of 2017.

Salaries and benefits totaled $4,618,000 for the quarter ended March31, 2017, compared to 3,599,000 for the same period a year ago, an increase of $1,019,000, primarily due to increases to staff from the FANB acquisition. Occupancy and equipment expense increased $203,000 to $782,000 for the first quarter of 2017 compared to $579,000 during the same period in 2016, reflecting an increase in costs relating to the three new FANB branches. Expense increases were also experienced in data processing expense, legal and professional fees, audit fees, director fees and other expenses. Other Real Estate Owned expense declined $33,000 from the first quarter of 2016 to the first quarter of 2017.

Income Taxes

During the first quarter of 2017, we recognized income tax expense of $910,000 compared to income tax expense of $708,000 during the first quarter of 2016. Our effective tax rate was 38.6% in 2017 and 36.8% in 2016. The fluctuation in effective tax rates reflects the impact of a higher percentage of non-taxable earnings in 2016.

Financial Condition

Total assets increased to $562,569,000 at March 31, 2017 from $474,761,000 at March 31, 2016. The primary source of the increase in assets was due to an increase in portfolio loans and assets acquired in the FANB acquisition, offset by a decline in Mortgage loans held for sale. The SBA portfolio loan increased $8,261,000 and the Company's Community Banking loan portfolio grew $95,209,000, of which $81,300,000 was acquired as part of the acquisition. Mortgage loans held in the portfolio increased from last year by $1,306,000. Additionally, premises and equipment increased $6,295,000 due primarily due to the FANB acquisition. Loans Held for Sale declined $28,510,000 and Other Real Estate declined $1,335,000 from March 31, 2016 to March 31, 2017. Total assets at March 31, 2017 remained relatively flat from the December 31, 2016 total of $561,389,000.

Total liabilities at March 31, 2017 increased $69,048,000, when compared to March 31, 2016. The increase in liabilities was driven by additional deposits acquired from FANB. Deposits increased $111,958,000 from $319,767,000 at March 31, 2016 to $431,725,000 at March 31, 2017. A total of $98,215,000 in deposits were acquired from FANB at the acquisition date. FHLB and other borrowings declined $37,418,000 from March 31, 2016 to March 31, 2017 in relation to the decline in loans held for sale.

Consolidated Stockholders Equity increased from $34,753,000 at March 31, 2016 to $53,513,000 at March 31, 2017. The Company's total risk based capital ratio was 20.83% at March 31, 2017 compared to 20.11% at March 31, 2016. The Company's Tier 1 leverage ratio was 10.87% at March 31, 2017 compared to 9.67% at March 31, 2016.

Investment Securities

The balance of investment securities available for sale increased to $25,324,000 at March 31, 2017 from $19,971,000 at March 31, 2016.

The following table presents the investments by category at the end of March 31, 2017 and 2016.

Available for sale	2017		2016	
(In thousands)	**Amortized Cost**	**Estimated Fair Value**	**Amortized Cost**	**Estimated Fair Value**
State and municipal securities	$ 5,324	$ 5,522	$ 3,128	$ 3,484
Corporate	958	975	-	-
Mortgage-backed securities	18,698	18,827	16,191	16,487
	$ 24,980	$ 25,324	$ 19,319	$ 19,971

The following table presents the maturities of investment securities at carrying value and the weighted average yields for each range of maturities presented. Yields are based on amortized cost of securities.

Maturities at March 31, 2017 (In thousands)	**State and Municipal Securities**	**Weighted Average Yield**	**Corporate Securities**	**Weighted Average Yield**	**Mortgage Backed Securities**	**Weighted Average Yield**
Within 1 year	$ -	-	$ -	-	$ 40	5.12%
After 1 through 5 years	1,829	3.47%	-	-	12,268	2.42%
After 5 through 10 years	3,248	2.87%	958	2.79 %	4,294	2.29%
After 10 years	247	3.10%	-	-	2,096	2.83%
Totals	$ 5,324	3.08%	$ 958	2.79%	$ 18,698	2.44%

Mortgage-backed securities are included in the maturities categories in which they are anticipated to be repaid based on scheduled maturities.

Loans

Gross loans totaled $403,082,000 at March 31, 2017, a $104,820,000, or 35.1% increase from the $298,262,000 at March 31, 2016. Loans of $81,426,000 were acquired in the FANB acquisition. Balances within the major loans receivable categories and geographic concentration of the loan portfolio are presented below.

	Geographic Concentration of Loan Portfolio			
	March 31, 2017			
(In thousands)	Florida	Georgia	South Carolina	Other
Commercial and financial	$ 19,289	$ 3,710	$ 2,885	$ 800
Real estate – construction, commercial	20,085	2,930	5,114	2,433
Real estate – construction, residential	10,471	3,852	4,676	315
Real estate – mortgage, commercial	102,100	18,589	31,736	6,161
Real estate – mortgage, residential	66,175	50,950	24,670	10,516
Real estate – mortgage, farmland	5,608	163	—	4,770
Consumer installment loans	4,262	90	685	47
	$ 227,990	$ 80,284	$ 69,766	$ 25,042

	Geographic Concentration of Loan Portfolio			
	March 31, 2016			
(In thousands)	Florida	Georgia	South Carolina	Other
Commercial and financial	$ 10,664	3,123	3,079	3,002
Agricultural	—	—	14	—
Real estate – construction, commercial	8,509	1,451	6,053	2,445
Real estate – construction, residential	6,048	5,666	3,986	194
Real estate – mortgage, commercial	58,379	18,674	27,389	9,027
Real estate – mortgage, residential	47,311	37,177	25,554	10,608
Real estate – mortgage, farmland	3,581	249	—	4,850
Consumer installment loans	299	255	624	51
	$ 134,791	66,595	66,699	30,177

Other Real Estate Owned (OREO)

Other real estate owned (OREO) represents collateral property taken back from borrowers in partial or full satisfaction of their defaulted debt obligation to the Company. OREO declined from $6,292,000 at March 31, 2016 to $4,957,000 at March, 2017 as the Company continued the downward trend and reduced loss exposure over the past few years. We track our historical experience of loans that ultimately convert to OREO by collateral type and by geographic exposure as shown on the following tables:

	Book Value of Other Real Estate Owned at March 31, 2017			
(In thousands)	Florida	South Carolina	Other	Total
Residential	$ -	$ -	$ -	$ -
Commercial	1,441	642	749	2,832
Finished lots	124	284	-	408
Raw land	1,717	-	-	1,717
	$ 3,282	$ 926	$ 749	$ 4,957

	Book Value of Other Real Estate Owned at March 31, 2016		
(In thousands)	Florida	South Carolina	Total
Residential	$ 158	$ —	$ 158
Commercial	2,277	1,045	3,322
Finished lots	227	663	890
Raw land	1,726	196	1,922
	$ 4,388	$ 1,904	$ 6,292

Deposits

Deposits increased from $319,767,000 at March 31, 2016 to $431,725,000 at March 31, 2017, an increase of $111,958,000. A total of $98,215,000 in deposits were acquired in the FANB acquisition. Balances within the major deposit categories are as follows:

	March 31, 2017		
(In thousands)	Core Retail Deposits	Brokered Deposits(incl. CDARs)	Total Deposits
Noninterest-bearing demand deposits	$ 82,424	$ —	$ 82,424
Interest-bearing demand deposits	178,010	—	178,010
Savings deposits	16,768	—	16,768
Certificates of deposit $100,000 and over	76,714	37,933	114,647
Other time deposits	26,980	12,896	39,876
	$ 380,896	$ 50,829	$ 431,725

	March 31, 2016		
(In thousands)	Core Retail Deposits	Brokered Deposits(incl. CDARs)	Total Deposits
Noninterest-bearing demand deposits	$ 43,879	$ —	$ 43,879
Interest-bearing demand deposits	127,858	—	127,858
Savings deposits	5,262	—	5,262
Certificates of deposit $100,000 and over	36,591	57,601	94,192
Other time deposits	34,315	14,261	48,576
	$ 247,905	$ 71,862	$ 319,767

Other Borrowings and Liquidity

Federal Home Loan Bank (FHLB) borrowings totaled $49,700,000 at March 31, 2017, a decrease from $91,000,000 outstanding on March 31, 2016. The Bank maintains relationships with six other correspondent banks that can provide funds on short notice for unsecured advances for up to $44,000,000. The Bank also has non-core funding available of $227,882,000 at March 31, 2017 over the amount outstanding at quarter-end of $19,218,000. Additionally, the discount window at the Federal Reserve is available to provide as much as $41,837,000.

As of March 31, 2017, the Company had $472,120,000, in total borrowing capacity, of which we had utilized $68,918,000 or 14.6%, leaving remaining available liquidity of $403,202,000. The following tables present available sources of liquidity at March 31, 2017 and March 31, 2016:

(In Thousands)	March 31, 2017		
	Total Line of Credit	Funds Borrowed	Funds Available
Available Sources of Liquidity			
Federal Funds Purchased Lines of Credit	$ 44,000	$ —	$ 44,000
Total Non-Core Deposit Sources	227,882	19,218	208,664
Federal Reserve Borrowing Capacity at Discount Window	41,837	—	41,837
Federal Home Loan Bank Advance Availability	158,401	49,700	108,701
Total Sources of Liquidity	$ 472,120	$ 68,918	$ 403,202
Borrowing Sources Utilized %	14.6%		

	March 31, 2016		
	Total Line of Credit	Funds Borrowed	Funds Available
Available Sources of Liquidity			
Federal Funds Purchased Lines of Credit	$ 37,000	$ —	$ 37,000
Total Non-Core Deposit Sources	189,726	45,422	144,304
Federal Reserve Borrowing Capacity at Discount Window	17,462	—	17,462
Federal Home Loan Bank Advance Availability	139,310	91,000	48,310
Total Sources of Liquidity	$ 383,498	$ 136,422	$ 247,076
Borrowing Sources Utilized %	35.6%		

Coastal Banking Company
Consolidated Balance Sheets

	March 31, 2017 (unaudited)	December 31, 2016 (audited)
Assets		
Cash and due from banks	$ 9,587,795	$ 7,956,004
Interest-bearing deposits in banks		
Federal funds sold	184,588	387,123
Securities available for sale, at fair value	25,323,952	19,667,769
Restricted equity securities, at cost	4,409,368	4,992,287
Loans held for sale, at fair value	95,845,656	92,009,241
Loans, net of unearned income	403,081,514	408,743,325
Less allowance for loan losses	5,618,072	5,990,733
Loans, net	397,463,442	402,752,592
Premises and equipment, net	13,479,317	13,604,166
Cash surrender value of life insurance	2,382,627	2,362,805
SBA loan servicing rights	1,473,487	1,403,431
Intangible assets	731,758	813,716
Other real estate owned	4,956,572	5,061,661
Accrued interest receivable	1,185,415	1,242,703
Other assets	5,544,749	9,135,228
Total assets	$ 562,568,726	$ 561,388,726
Liabilities and Shareholders' Equity		
Deposits:		
Noninterest-bearing	$ 82,424,329	$ 77,603,027
Interest-bearing	178,010,237	174,112,178
Savings	16,767,772	15,618,336
Time	154,522,728	149,983,376
Total deposits	431,725,066	417,316,917
FHLB advances and other borrowings	49,700,000	63,050,000
Senior note payable	8,666,667	8,916,667
Junior subordinated debentures	7,217,000	7,217,000
Accrued interest payable	243,636	198,018
Other liabilities	11,503,282	12,974,832
Total liabilities	509,055,651	509,673,434
Commitments and contingencies		
Shareholders' Equity:		
Common stock, par value $.01; 10,000,000 shares authorized; 3,670,203 shares issued and outstanding at March 31, 2017; 3,647,489 shares issued and outstanding at December 31, 2016	36,702	36,475
Additional paid-in capital	53,689,837	53,354,382
Accumulated deficit	(421,768)	(1,870,203)
Accumulated other comprehensive income	208,304	194,638
Total shareholders' equity	53,513,075	51,715,292
Total liabilities and shareholders' equity	$ 562,568,726	$ 561,388,726

Coastal Banking Company
Consolidated Statements of Income
(Unaudited)

	For the three months ending March 31,	
	2017	**2016**
Interest income:		
Interest and fees on loans	$ 5,814,891	$ 4,508,908
Interest on securities	206,177	193,701
Interest on deposits in other banks	1,067	4,442
Interest on federal funds sold	44,436	345
Total interest income	6,066,571	4,707,396
Interest expense:		
Interest on deposits	677,016	411,921
Interest on junior subordinated debentures	54,600	49,557
Interest on other borrowings	227,031	305,594
Total interest expense	958,647	767,072
Net interest income	5,107,924	3,940,324
Provision for loan losses	294,836	33,409
Net interest income after provision for loan losses	4,813,088	3,906,915
Non-interest income:		
Service charges on deposit accounts	64,635	52,847
Other service charges, commissions and fees	177,234	110,117
SBA loan income	1,025,043	580,146
Mortgage banking income	3,407,778	2,929,058
Income from investment in life insurance contracts	19,878	21,666
Other income	76,586	2,605
Total other income	4,771,154	3,696,439
Non-interest expenses:		
Salaries and employee benefits	4,617,769	3,599,239
Mortgage loan expense	93,389	127,215
Occupancy and equipment expense	781,908	579,243
Data processing fees	448,293	376,497
Other real estate expenses	(14,949)	17,990
Legal and other professional fees	281,968	153,980
Audit fees	130,264	94,377
Advertising fees	136,318	133,352
FDIC insurance expense	44,069	81,000
Director fees	105,250	74,100
OCC examination fees	38,772	37,590
Other operating	563,081	402,859
Total other expenses	7,226,132	5,677,442
Income before income tax	2,358,110	1,925,912
Income tax expense	909,676	707,968
Net income	$ 1,448,434	$ 1,217,944
Earnings per share (basic)	$ 0.40	$ 0.45
Earnings per share (diluted)	$ 0.38	$ 0.44