

REPUBLIC FIRST BANCORP INC  
Form 10-Q  
August 06, 2014

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended June 30, 2014.

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_ to \_\_\_\_.

Commission File Number: 000-17007

Republic First Bancorp, Inc.  
(Exact name of registrant as specified in its charter)

|                                                                   |                                         |
|-------------------------------------------------------------------|-----------------------------------------|
| Pennsylvania                                                      | 23-2486815                              |
| (State or other jurisdiction of<br>incorporation or organization) | (I.R.S. Employer<br>Identification No.) |

|                                                     |            |
|-----------------------------------------------------|------------|
| 50 South 16th Street, Philadelphia,<br>Pennsylvania | 19102      |
| (Address of principal executive<br>offices)         | (Zip code) |

215-735-4422

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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 of 1934 during the preceding 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  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Sec.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  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated 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  Accelerated filer   
Non-Accelerated filer  Smaller reporting  
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

|                         |                                                      |
|-------------------------|------------------------------------------------------|
| Common Stock, par value | 37,815,003                                           |
| \$0.01 per share        |                                                      |
| Title of Class          | Number of Shares Outstanding as<br>of August 5, 2014 |

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Republic First Bancorp, Inc. and Subsidiaries  
Consolidated Balance Sheets  
June 30, 2014 and December 31, 2013  
(Dollars in thousands, except per share data)  
(unaudited)

|                                                                                                                                                             | June 30,<br>2014    | December<br>31,<br>2013 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|-------------------------|
| <b>ASSETS</b>                                                                                                                                               |                     |                         |
| Cash and due from banks                                                                                                                                     | \$ 17,070           | \$ 12,525               |
| Interest bearing deposits with banks                                                                                                                        | 66,050              | 23,355                  |
| Cash and cash equivalents                                                                                                                                   | 83,120              | 35,880                  |
| Investment securities available for sale, at fair value                                                                                                     | 219,634             | 204,891                 |
| Investment securities held to maturity, at amortized cost (fair value of \$21 and \$21, respectively)                                                       | 21                  | 21                      |
| Restricted stock, at cost                                                                                                                                   | 1,725               | 1,570                   |
| Loans held for sale                                                                                                                                         | 491                 | 4,931                   |
| Loans receivable (net of allowance for loan losses of \$12,063 and \$12,263, respectively)                                                                  | 706,806             | 667,048                 |
| Premises and equipment, net                                                                                                                                 | 29,041              | 22,748                  |
| Other real estate owned, net                                                                                                                                | 3,637               | 4,059                   |
| Accrued interest receivable                                                                                                                                 | 3,104               | 3,049                   |
| Other assets                                                                                                                                                | 17,555              | 17,468                  |
| <b>Total Assets</b>                                                                                                                                         | <b>\$ 1,065,134</b> | <b>\$ 961,665</b>       |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                                                                                 |                     |                         |
| <b>Liabilities</b>                                                                                                                                          |                     |                         |
| <b>Deposits</b>                                                                                                                                             |                     |                         |
| Demand – non-interest bearing                                                                                                                               | \$ 199,553          | \$ 157,806              |
| Demand – interest bearing                                                                                                                                   | 212,710             | 230,221                 |
| Money market and savings                                                                                                                                    | 431,612             | 402,671                 |
| Time deposits                                                                                                                                               | 80,809              | 78,836                  |
| <b>Total Deposits</b>                                                                                                                                       | <b>924,684</b>      | <b>869,534</b>          |
| Accrued interest payable                                                                                                                                    | 292                 | 237                     |
| Other liabilities                                                                                                                                           | 6,259               | 6,519                   |
| Subordinated debt                                                                                                                                           | 22,476              | 22,476                  |
| <b>Total Liabilities</b>                                                                                                                                    | <b>953,711</b>      | <b>898,766</b>          |
| <b>Shareholders' Equity</b>                                                                                                                                 |                     |                         |
| Preferred stock, par value \$0.01 per share: 10,000,000 shares authorized; no shares issued                                                                 | -                   | -                       |
| Common stock, par value \$0.01 per share: 50,000,000 shares authorized; shares issued 38,343,848 as of June 30, 2014 and 26,501,742 as of December 31, 2013 | 383                 | 265                     |
| Additional paid in capital                                                                                                                                  | 152,131             | 107,078                 |
| Accumulated deficit                                                                                                                                         | (36,416)            | (37,708)                |
| Treasury stock at cost (416,303 shares)                                                                                                                     | (3,099)             | (3,099)                 |
| Stock held by deferred compensation plan (112,542 shares)                                                                                                   | (809)               | (809)                   |

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|                                            |              |            |
|--------------------------------------------|--------------|------------|
| Accumulated other comprehensive loss       | (767)        | (2,828)    |
| Total Shareholders' Equity                 | 111,423      | 62,899     |
| Total Liabilities and Shareholders' Equity | \$ 1,065,134 | \$ 961,665 |

(See notes to consolidated financial statements)

Republic First Bancorp, Inc. and Subsidiaries  
Consolidated Statements of Income  
For the Three and Six Months Ended June 30, 2014 and 2013  
(Dollars in thousands, except per share data)  
(unaudited)

|                                                                  | Three Months Ended June 30, |          | Six Months Ended June 30, |           |
|------------------------------------------------------------------|-----------------------------|----------|---------------------------|-----------|
|                                                                  | 2014                        | 2013     | 2014                      | 2013      |
| Interest income:                                                 |                             |          |                           |           |
| Interest and fees on taxable loans                               | \$ 8,226                    | \$ 7,991 | \$ 16,467                 | \$ 15,828 |
| Interest and fees on tax-exempt loans                            | 84                          | 89       | 166                       | 180       |
| Interest and dividends on taxable investment securities          | 1,188                       | 1,043    | 2,429                     | 2,090     |
| Interest and dividends on tax-exempt investment securities       | 83                          | 48       | 162                       | 121       |
| Interest on federal funds sold and other interest-earning assets | 50                          | 44       | 62                        | 103       |
| Total interest income                                            | 9,631                       | 9,215    | 19,286                    | 18,322    |
| Interest expense:                                                |                             |          |                           |           |
| Demand- interest bearing                                         | 225                         | 207      | 416                       | 402       |
| Money market and savings                                         | 467                         | 428      | 883                       | 930       |
| Time deposits                                                    | 178                         | 204      | 351                       | 483       |
| Other borrowings                                                 | 277                         | 278      | 553                       | 556       |
| Total interest expense                                           | 1,147                       | 1,117    | 2,203                     | 2,371     |
| Net interest income                                              | 8,484                       | 8,098    | 17,083                    | 15,951    |
| Provision for loan losses                                        | 300                         | 925      | 300                       | 925       |
| Net interest income after provision for loan losses              | 8,184                       | 7,173    | 16,783                    | 15,026    |
| Non-interest income:                                             |                             |          |                           |           |
| Loan advisory and servicing fees                                 | 466                         | 436      | 903                       | 774       |
| Gain on sales of SBA loans                                       | 1,046                       | 2,107    | 2,200                     | 2,757     |
| Service fees on deposit accounts                                 | 287                         | 265      | 580                       | 499       |
| Legal settlements                                                | -                           | -        | -                         | 238       |
| Gain on sale of investment securities                            | 458                         | -        | 458                       | 703       |
| Other-than-temporary impairment                                  | 21                          | -        | 21                        | -         |
| Portion recognized in other comprehensive income (before taxes)  | (28 )                       | -        | (28 )                     | -         |
| Net impairment loss on investment securities                     | (7 )                        | -        | (7 )                      | -         |
| Bank owned life insurance income                                 | -                           | -        | -                         | 13        |
| Other non-interest income                                        | 39                          | 62       | 85                        | 129       |
| Total non-interest income                                        | 2,289                       | 2,870    | 4,219                     | 5,113     |
| Non-interest expenses:                                           |                             |          |                           |           |
| Salaries and employee benefits                                   | 4,828                       | 4,503    | 9,868                     | 8,790     |
| Occupancy                                                        | 1,027                       | 876      | 2,065                     | 1,720     |
| Depreciation and amortization                                    | 571                         | 472      | 1,069                     | 955       |
| Legal                                                            | 444                         | 503      | 699                       | 867       |
| Other real estate owned                                          | 340                         | 109      | 686                       | 1,026     |
| Advertising                                                      | 214                         | 117      | 362                       | 218       |

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|                                        |         |          |          |          |
|----------------------------------------|---------|----------|----------|----------|
| Data processing                        | 354     | 307      | 654      | 415      |
| Insurance                              | 122     | 153      | 279      | 311      |
| Professional fees                      | 428     | 359      | 830      | 682      |
| Regulatory assessments and costs       | 196     | 241      | 533      | 585      |
| Taxes, other                           | 234     | 253      | 449      | 503      |
| Other operating expenses               | 1,199   | 1,163    | 2,278    | 2,114    |
| Total non-interest expense             | 9,957   | 9,056    | 19,772   | 18,186   |
| Income before benefit for income taxes | 516     | 987      | 1,230    | 1,953    |
| Benefit for income taxes               | (21 )   | (24 )    | (62 )    | (50 )    |
| Net income                             | \$ 537  | \$ 1,011 | \$ 1,292 | \$ 2,003 |
| Net income per share:                  |         |          |          |          |
| Basic                                  | \$ 0.02 | \$ 0.04  | \$ 0.04  | \$ 0.08  |
| Diluted                                | \$ 0.02 | \$ 0.04  | \$ 0.04  | \$ 0.08  |

(See notes to consolidated financial statements)

Republic First Bancorp, Inc. and Subsidiaries  
Consolidated Statements of Comprehensive Income (Loss)  
For the Three and Six Months Ended June 30, 2014 and 2013  
(Dollars in thousands)  
(unaudited)

|                                                                                                         | Three Months Ended June 30, |             | Six Months Ended June 30, |           |
|---------------------------------------------------------------------------------------------------------|-----------------------------|-------------|---------------------------|-----------|
|                                                                                                         | 2014                        | 2013        | 2014                      | 2013      |
| Net income                                                                                              | \$ 537                      | \$ 1,011    | \$ 1,292                  | \$ 2,003  |
| Other comprehensive income (loss), net of tax                                                           |                             |             |                           |           |
| Unrealized gain (loss) on securities (pre-tax \$1,610, \$(3,504), \$3,666, and \$(3,498), respectively) | 1,032                       | (2,246 )    | 2,350                     | (2,242 )  |
| Reclassification adjustment for securities gains (pre-tax \$458, \$-, \$458, and \$703, respectively)   | (293 )                      | -           | (293 )                    | (450 )    |
| Reclassification adjustment for impairment charge (pre-tax \$7, \$-, \$7, and \$-, respectively)        | 4                           | -           | 4                         | -         |
| Total other comprehensive income (loss)                                                                 | 743                         | (2,246 )    | 2,061                     | (2,692 )  |
| Total comprehensive income (loss)                                                                       | \$ 1,280                    | \$ (1,235 ) | \$ 3,353                  | \$ (689 ) |

(See notes to consolidated financial statements)

Republic First Bancorp, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
For the Six Months Ended June 30, 2014 and 2013  
(Dollars in thousands)  
(unaudited)

|                                                                                   | Six Months Ended June<br>30, |           |
|-----------------------------------------------------------------------------------|------------------------------|-----------|
|                                                                                   | 2014                         | 2013      |
| Cash flows from operating activities                                              |                              |           |
| Net income                                                                        | \$1,292                      | \$2,003   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |           |
| Provision for loan losses                                                         | 300                          | 925       |
| Gain on sale of other real estate owned                                           | -                            | (229 )    |
| Write down of other real estate owned                                             | 552                          | 809       |
| Depreciation and amortization                                                     | 1,069                        | 955       |
| Stock based compensation                                                          | 198                          | 155       |
| Gain on sale and call of investment securities                                    | (458 )                       | (703 )    |
| Impairment charges on investment securities                                       | 7                            | -         |
| Amortization of premiums on investment securities                                 | 293                          | 380       |
| Proceeds from sales of SBA loans originated for sale                              | 23,370                       | 27,410    |
| SBA loans originated for sale                                                     | (16,730 )                    | (24,853 ) |
| Gains on sales of SBA loans originated for sale                                   | (2,200 )                     | (2,757 )  |
| Increase in value of bank owned life insurance                                    | -                            | (13 )     |
| Increase in accrued interest receivable and other assets                          | (1,295 )                     | (416 )    |
| Decrease in accrued interest payable and other liabilities                        | (205 )                       | (109 )    |
| Net cash provided by operating activities                                         | 6,193                        | 3,557     |
| Cash flows from investing activities                                              |                              |           |
| Purchase of investment securities available for sale                              | (31,364 )                    | (25,289 ) |
| Proceeds from the sale of securities available for sale                           | 5,700                        | 7,946     |
| Proceeds from the maturity or call of securities available for sale               | 14,293                       | 18,352    |
| Net (purchase) redemption of restricted stock                                     | (155 )                       | 1,490     |
| Net increase in loans                                                             | (40,251 )                    | (21,213 ) |
| Net proceeds from sale of other real estate owned                                 | 63                           | 1,994     |
| Surrender proceeds on bank owned life insurance                                   | -                            | 10,503    |
| Premises and equipment expenditures                                               | (7,362 )                     | (211 )    |
| Net cash used in investing activities                                             | (59,076 )                    | (6,428 )  |
| Cash flows from financing activities                                              |                              |           |
| Net proceeds from stock offering                                                  | 44,973                       | -         |
| Net increase (decrease) in demand, money market and savings deposits              | 53,177                       | (33,325 ) |
| Net increase (decrease) in time deposits                                          | 1,973                        | (35,024 ) |
| Net cash provided by (used in) financing activities                               | 100,123                      | (68,349 ) |
| Net increase (decrease) in cash and cash equivalents                              | 47,240                       | (71,220 ) |
| Cash and cash equivalents, beginning of year                                      | 35,880                       | 128,004   |
| Cash and cash equivalents, end of period                                          | \$83,120                     | \$56,784  |

Supplemental disclosures:

|                                                          |         |         |
|----------------------------------------------------------|---------|---------|
| Interest paid                                            | \$2,148 | \$2,150 |
| Income taxes paid                                        | \$70    | \$175   |
| Non-cash transfers from loans to other real estate owned | \$193   | \$246   |

(See notes to consolidated financial statements)

Republic First Bancorp, Inc. and Subsidiaries  
Consolidated Statements of Changes in Shareholders' Equity  
For the Six Months Ended June 30, 2014 and 2013  
(Dollars in thousands)  
(unaudited)

|                                                                                                                                             | Common<br>Stock | Additional<br>Paid in<br>Capital | Accumulated<br>Deficit | Treasury<br>Stock | Stock Held by<br>Deferred<br>Compensation<br>Plan | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total<br>Shareholders'<br>Equity |
|---------------------------------------------------------------------------------------------------------------------------------------------|-----------------|----------------------------------|------------------------|-------------------|---------------------------------------------------|--------------------------------------------------------|----------------------------------|
| Balance                                                                                                                                     |                 |                                  |                        |                   |                                                   |                                                        |                                  |
| January 1, 2014                                                                                                                             | \$265           | \$107,078                        | \$(37,708)             | \$(3,099)         | \$(809)                                           | \$(2,828)                                              | \$62,899                         |
| Net income                                                                                                                                  |                 |                                  | 1,292                  |                   |                                                   |                                                        | 1,292                            |
| Other<br>comprehensive<br>income, net of<br>tax                                                                                             |                 |                                  |                        |                   |                                                   | 2,061                                                  | 2,061                            |
| Proceeds from<br>shares issued<br>under<br>common<br>stock offering<br>(11,842,106<br>shares) net of<br>offering costs<br>(pre-tax<br>\$27) | 118             | 44,855                           |                        |                   |                                                   |                                                        | 44,973                           |
| Stock based<br>compensation                                                                                                                 |                 | 198                              |                        |                   |                                                   |                                                        | 198                              |
| Balance June<br>30, 2014                                                                                                                    | \$383           | \$152,131                        | \$(36,416)             | \$(3,099)         | \$(809)                                           | \$(767)                                                | \$111,423                        |
| Balance                                                                                                                                     |                 |                                  |                        |                   |                                                   |                                                        |                                  |
| January 1, 2013                                                                                                                             | \$265           | \$106,753                        | \$(34,228)             | \$(3,099)         | \$(809)                                           | \$1,020                                                | \$69,902                         |
| Net income                                                                                                                                  |                 |                                  | 2,003                  |                   |                                                   |                                                        | 2,003                            |
| Other<br>comprehensive<br>loss, net of tax                                                                                                  |                 |                                  |                        |                   |                                                   | (2,692)                                                | (2,692)                          |
| Stock based<br>compensation                                                                                                                 |                 | 155                              |                        |                   |                                                   |                                                        | 155                              |
|                                                                                                                                             | \$265           | \$106,908                        | \$(32,225)             | \$(3,099)         | \$(809)                                           | \$(1,672)                                              | \$69,368                         |

Balance June  
30, 2013

(See notes to consolidated financial statements)

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Republic First Bancorp, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

Note 1: Basis of Presentation

Republic First Bancorp, Inc. (the “Company”) is a corporation incorporated under the laws of the Commonwealth of Pennsylvania and a registered bank holding company. The Company offers a variety of retail and commercial banking services to individuals and businesses throughout the Greater Philadelphia and Southern New Jersey area through its wholly-owned subsidiary, Republic First Bank (“Republic” or the “Bank”) which does business under the name Republic Bank. The Company also has three unconsolidated subsidiaries, which are statutory trusts established by the Company in connection with its sponsorship of three separate issuances of trust preferred securities.

The Company and Republic encounter vigorous competition for market share in the geographic areas they serve from bank holding companies, national, regional and other community banks, thrift institutions, credit unions and other non-bank financial organizations, such as mutual fund companies, insurance companies and brokerage companies.

The Company and Republic are subject to regulations of certain state and federal agencies. These regulatory agencies periodically examine the Company and Republic for adherence to laws and regulations. As a consequence, the cost of doing business may be affected.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Republic. The Company follows accounting standards set by the Financial Accounting Standards Board (“FASB”). The FASB sets accounting principles generally accepted in the United States of America (“U.S. GAAP”) that are followed to ensure consistent reporting of financial condition, results of operations, and cash flows.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. GAAP for interim financial information and with the instructions to United States Securities and Exchange Commission (“SEC”) Form 10-Q and Article 10 of SEC Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for financial statements for a complete fiscal year. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. All significant inter-company accounts and transactions have been eliminated in the consolidated financial statements. The Company has evaluated subsequent events through the date of issuance of the financial data included herein.

Note 2: Summary of Significant Accounting Policies

Risks and Uncertainties

The earnings of the Company depend primarily on the earnings of Republic. The earnings of Republic are dependent primarily upon the level of net interest income, which is the difference between interest earned on its interest-earning assets, such as loans and investments, and the interest paid on its interest-bearing liabilities, such as deposits and borrowings. Accordingly, the Company’s results of operations are subject to risks and uncertainties surrounding Republic’s exposure to changes in the interest rate environment.

Prepayments on residential real estate mortgage and other fixed rate loans and mortgage-backed securities vary significantly and may cause significant fluctuations in interest margins.



## Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant estimates are made by management in determining the allowance for loan losses, carrying values of other real estate owned, assessment of other than temporary impairment (“OTTI”) of investment securities, fair value of financial instruments and the realization of deferred income tax assets. Consideration is given to a variety of factors in establishing these estimates.

In estimating the allowance for loan losses, management considers current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, borrowers’ perceived financial and managerial strengths, the adequacy of underlying collateral, if collateral dependent, or present value of future cash flows, and other relevant factors. An estimate for the carrying value of other real estate owned is normally determined through appraisals which are updated on a regular basis or through agreements of sale that have been negotiated. Because the allowance for loan losses and carrying value of other real estate owned are dependent, to a great extent, on the general economy and other conditions that may be beyond the Company’s and Republic’s control, the estimates of the allowance for loan losses and the carrying values of other real estate owned could differ materially in the near term.

In estimating OTTI of investment securities, securities are evaluated on at least a quarterly basis and more frequently when market conditions warrant such an evaluation, to determine whether a decline in their value is other than temporary. To determine whether a loss in value is other than temporary, management utilizes criteria such as the reasons underlying the decline, the magnitude and duration of the decline, the intent to hold the security and the likelihood of the Company not being required to sell the security prior to an anticipated recovery in the fair value. The term “other than temporary” is not intended to indicate that the decline is permanent, but indicates that the prospect for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

In evaluating the Company’s ability to recover deferred tax assets, management considers all available positive and negative evidence. Management also makes assumptions on the amount of future taxable income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require management to make judgments that are consistent with the plans and estimates used to manage the Company’s business. As a result of cumulative losses in recent years and the slow pace of recovery in the current economic environment, the Company has decided to currently exclude future taxable income from its analysis of the ability to recover deferred tax assets and has recorded a valuation allowance against its deferred tax assets. An increase or decrease in the valuation allowance would result in an adjustment to income tax expense in the period and could have a significant impact on the Company’s future earnings.

## Stock-Based Compensation

The Company has a Stock Option and Restricted Stock Plan (“Plan”), under which the Company may grant options, restricted stock or stock appreciation rights to the Company’s employees, directors, and certain consultants. The Plan became effective on November 14, 1995, and was amended and approved at the Company’s 2005 annual meeting of shareholders. Under the terms of the Plan, 1.5 million shares of common stock, plus an annual increase equal to the number of shares needed to restore the maximum number of shares that may be available for grant under the Plan to

1.5 million shares, are available for such grants. As of June 30, 2014, the only grants under the Plan have been option grants. The Plan provides that the exercise price of each option granted equals the market price of the Company's stock on the date of the grant. Options granted pursuant to the Plan vest within one to four years and have a maximum term of 10 years.

On April 29, 2014 the Company's shareholders approved the 2014 Equity Incentive Plan (the "2014 Plan"), under which the Company may grant options, restricted stock, stock units, or stock appreciation rights to the Company's employees, directors, independent contractors, and consultants. Under the terms of the 2014 Plan, 2.6 million shares of common stock, plus an annual adjustment to be no less than 10% of the outstanding shares or such lower number as the Board of Directors may determine, are available for such grants.

The Company utilizes the Black-Scholes option pricing model to calculate the estimated fair value of each stock option granted on the date of the grant. A summary of the assumptions used in the Black-Scholes option pricing model for 2014 and 2013 are as follows:

|                            | 2014             | 2013             |
|----------------------------|------------------|------------------|
| Dividend yield(1)          | 0.0%             | 0.0%             |
| Expected volatility(2)     | 55.79% to 57.99% | 54.88% to 55.08% |
| Risk-free interest rate(3) | 1.51% to 2.13%   | 1.28% to 2.02%   |
| Expected life(4)           | 5.5 to 7.0 years | 7.0 years        |

(1) A dividend yield of 0.0% is utilized because cash dividends have never been paid.

(2) Expected volatility is based on Bloomberg's five and one-half to seven year volatility calculation for "FRBK" stock.

(3) The risk-free interest rate is based on the five to seven year Treasury bond.

(4) The expected life reflects a 1 to 4 year vesting period, the maximum ten year term and review of historical behavior.

During the six months ended June 30, 2014 and 2013, 198,825 options and 109,787 options vested, respectively. Expense is recognized ratably over the period required to vest. At June 30, 2014, the intrinsic value of the 1,501,149 options outstanding was \$2,635,473, while the intrinsic value of the 446,136 exercisable (vested) options was \$408,949. During the six months ended June 30, 2014, 68,781 options were forfeited with a weighted average grant date fair value of \$21,091.

Information regarding stock based compensation for the six months ended June 30, 2014 and 2013 is set forth below:

|                                              | 2014         | 2013         |
|----------------------------------------------|--------------|--------------|
| Stock based compensation expense recognized  | \$ 198,000   | \$ 155,000   |
| Number of unvested stock options             | 1,055,013    | 911,563      |
| Fair value of unvested stock options         | \$ 1,545,988 | \$ 1,245,470 |
| Amount remaining to be recognized as expense | \$ 910,590   | \$ 687,636   |

The remaining amount of \$910,590 will be recognized as expense through February 2018.

Earnings per Share

Earnings per share (“EPS”) consist of two separate components: basic EPS and diluted EPS. Basic EPS is computed by dividing net income by the weighted average number of common shares outstanding for each period presented. Diluted EPS is calculated by dividing net income by the weighted average number of common shares outstanding plus dilutive common stock equivalents (“CSEs”). CSEs consist of dilutive stock options granted through the Company’s Plan and 2014 Plan and convertible securities related to the trust preferred securities issued in 2008. In the diluted EPS computation, the after tax interest expense on the trust preferred securities issuance is added back to the net income. For the three and six months ended June 30, 2014 and 2013, the effect of CSEs (convertible securities related to the trust preferred securities only) and the related add back of after tax interest expense was considered anti-dilutive and therefore was not included in the EPS calculation.

The calculation of EPS for the three and six months ended June 30, 2014 and 2013 is as follows (in thousands, except per share amounts):

|                                                               | Three Months Ended June<br>30, |          | Six Months Ended June<br>30, |          |
|---------------------------------------------------------------|--------------------------------|----------|------------------------------|----------|
|                                                               | 2014                           | 2013     | 2014                         | 2013     |
| Net income (basic and diluted)                                | \$537                          | \$ 1,011 | \$1,292                      | \$ 2,003 |
| Weighted average shares outstanding                           | 35,157                         | 25,973   | 30,590                       | 25,973   |
| Net income per share – basic                                  | \$0.02                         | \$ 0.04  | \$0.04                       | \$ 0.08  |
| Weighted average shares outstanding (including dilutive CSEs) | 35,609                         | 26,103   | 30,932                       | 26,062   |
| Net income per share – diluted                                | \$0.02                         | \$ 0.04  | \$0.04                       | \$ 0.08  |

#### Recent Accounting Pronouncements

##### ASU 2014-04

In January 2014, the FASB issued ASU 2014-04, “Receivables – Troubled Debt Restructuring by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure – a consensus of the FASB Emerging Issues Task Force.” The guidance clarifies when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate property recognized. For public business entities, the ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For entities other than public business entities, the ASU is effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. The Company does not believe the adoption of the amendment to this guidance will have a material impact on the consolidated financial statements.

##### ASU 2014-09

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 660): Summary and Amendments that Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs – Contracts with Customers (Subtopic 340-40).” The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the codification. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2016. The Company is currently assessing the impact that this guidance will have on its consolidated financial statements, but does not expect the guidance to have a material impact on the Company’s consolidated financial statements.

#### Note 3: Legal Proceedings

The Company and Republic are from time to time parties (plaintiff or defendant) to lawsuits in the normal course of business. While any litigation involves an element of uncertainty, management is of the opinion that the liability of

the Company and Republic, if any, resulting from such actions will not have a material effect on the financial condition or results of operations of the Company and Republic.

## Note 4: Segment Reporting

The Company has one reportable segment: community banking. The community bank segment primarily encompasses the commercial loan and deposit activities of Republic, as well as consumer loan products in the area surrounding its stores.

## Note 5: Investment Securities

A summary of the amortized cost and market value of securities available for sale and securities held to maturity at June 30, 2014 and December 31, 2013 is as follows:

| (dollars in thousands)              | At June 30, 2014  |                              |                               |               |
|-------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
|                                     | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| Collateralized mortgage obligations | \$144,452         | \$1,106                      | \$(1,835 )                    | \$143,723     |
| Mortgage-backed securities          | 13,608            | 631                          | (39 )                         | 14,200        |
| Municipal securities                | 11,754            | 241                          | (51 )                         | 11,944        |
| Corporate bonds                     | 26,905            | 713                          | -                             | 27,618        |
| Asset-backed securities             | 18,727            | 320                          | -                             | 19,047        |
| Trust preferred securities          | 5,270             | -                            | (2,293 )                      | 2,977         |
| Other securities                    | 115               | 10                           | -                             | 125           |
| Total securities available for sale | \$220,831         | \$3,021                      | \$(4,218 )                    | \$219,634     |
| U.S. Government agencies            | \$1               | \$-                          | \$-                           | \$1           |
| Other securities                    | 20                | -                            | -                             | 20            |
| Total securities held to maturity   | \$21              | \$-                          | \$-                           | \$21          |

| (dollars in thousands)              | At December 31, 2013 |                              |                               |               |
|-------------------------------------|----------------------|------------------------------|-------------------------------|---------------|
|                                     | Amortized<br>Cost    | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| Collateralized mortgage obligations | \$127,242            | \$665                        | \$(4,467 )                    | \$123,440     |
| Mortgage-backed securities          | 15,669               | 623                          | (111 )                        | 16,181        |
| Municipal securities                | 9,737                | 68                           | (162 )                        | 9,643         |
| Corporate bonds                     | 32,174               | 1,079                        | -                             | 33,253        |
| Asset-backed securities             | 19,089               | 318                          | -                             | 19,407        |
| Trust preferred securities          | 5,277                | -                            | (2,427 )                      | 2,850         |
| Other securities                    | 115                  | 2                            | -                             | 117           |
| Total securities available for sale | \$209,303            | \$2,755                      | \$(7,167 )                    | \$204,891     |
| U.S. Government agencies            | \$1                  | \$-                          | \$-                           | \$1           |
| Other securities                    | 20                   | -                            | -                             | 20            |
| Total securities held to maturity   | \$21                 | \$-                          | \$-                           | \$21          |



The maturity distribution of the amortized cost and estimated market value of investment securities by contractual maturity at June 30, 2014 is as follows:

| (dollars in thousands)    | Available for Sale |            | Held to Maturity |            |
|---------------------------|--------------------|------------|------------------|------------|
|                           | Amortized Cost     | Fair Value | Amortized Cost   | Fair Value |
| Due in 1 year or less     | \$6,216            | \$6,304    | \$-              | \$-        |
| After 1 year to 5 years   | 99,871             | 99,886     | 21               | 21         |
| After 5 years to 10 years | 104,453            | 102,885    | -                | -          |
| After 10 years            | 10,291             | 10,559     | -                | -          |
| Total                     | \$220,831          | \$219,634  | \$21             | \$21       |

Expected maturities will differ from contractual maturities because borrowers have the right to call or prepay obligations with or without prepayment penalties.

As of June 30, 2014 and December 31, 2013, the collateralized mortgage obligations and mortgage backed securities included in the investment securities portfolio consist solely of securities issued by U.S. government sponsored agencies. There were no private label mortgage securities held in the investment securities portfolio as of those dates. The Company did not hold any mortgage-backed securities that were rated "Alt-A" or "Subprime" as of June 30, 2014 and December 31, 2013. In addition, the Company did not hold any private issued CMO's as of June 30, 2014 and December 31, 2013. As of June 30, 2014 and December 31, 2013, the asset-backed securities consisted solely of Sallie Mae bonds collateralized by student loans which are guaranteed by the U.S. Department of Education.

In instances when a determination is made that an other-than-temporary impairment exists with respect to a debt security but the investor does not intend to sell the debt security and it is more likely than not that the investor will not be required to sell the debt security prior to its anticipated recovery, accounting standards require the other-than-temporary impairment to be separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income. Impairment charges (credit losses) on trust preferred securities for both the three and six month periods ended June 30, 2014 amounted to \$7,000. There were no impairment charges (credit losses) on trust preferred securities for the three and six months ended June 30, 2013.

The following table presents a roll-forward of the balance of credit-related impairment losses on securities held at June 30, 2014 and 2013 for which a portion of OTTI was recognized in other comprehensive income:

| (dollars in thousands)                                                                                                                                                         | 2014    | 2013    |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------|---------|
| Beginning Balance, January 1st                                                                                                                                                 | \$3,959 | \$3,959 |
| Additional credit-related impairment loss on securities for which an other-than-temporary impairment was previously recognized                                                 | 7       | -       |
| Reductions for securities paid off during the period                                                                                                                           | -       | -       |
| Reductions for securities for which the amount previously recognized in other comprehensive income was recognized in earnings because the Company intends to sell the security | -       | -       |
| Ending Balance, June 30th                                                                                                                                                      | \$3,966 | \$3,959 |



The Company realized gross gains on the sale of securities of \$458,000 during the three and six months ended June 30, 2014. The related sale proceeds amounted to \$5.7 million. The tax provision applicable to these gross gains in 2014 amounted to approximately \$165,000. The Company realized gross gains on the sale of securities of \$703,000 during the six months ended June 30, 2013. The related sale proceeds amounted to \$7.9 million. The tax provision applicable to these gross gains in 2013 amounted to approximately \$253,000.

The following tables show the fair value and gross unrealized losses associated with the investment portfolio, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

| (dollars in thousands)              | At June 30, 2014    |                   |                   |                   |            |                   |
|-------------------------------------|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|                                     | Less than 12 months |                   | 12 months or more |                   | Total      |                   |
|                                     | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| Collateralized mortgage obligations | \$16,811            | \$71              | \$50,670          | \$1,764           | \$67,481   | \$1,835           |
| Mortgage-backed securities          | -                   | -                 | 1,106             | 39                | 1,106      | 39                |
| Municipal securities                | -                   | -                 | 1,374             | 51                | 1,374      | 51                |
| Trust preferred securities          | -                   | -                 | 2,977             | 2,293             | 2,977      | 2,293             |
| Total                               | \$16,811            | \$71              | \$56,127          | \$4,147           | \$72,938   | \$4,218           |

| (dollars in thousands)              | At December 31, 2013 |                   |                   |                   |            |                   |
|-------------------------------------|----------------------|-------------------|-------------------|-------------------|------------|-------------------|
|                                     | Less than 12 months  |                   | 12 months or more |                   | Total      |                   |
|                                     | Fair Value           | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| Collateralized mortgage obligations | \$73,137             | \$3,923           | \$8,697           | \$544             | \$81,834   | \$4,467           |
| Mortgage-backed securities          | 1,450                | 41                | 1,123             | 70                | 2,573      | 111               |
| Municipal Securities                | 5,108                | 162               | -                 | -                 | 5,108      | 162               |
| Trust preferred securities          | -                    | -                 | 2,850             | 2,427             | 2,850      | 2,427             |
| Total                               | \$79,695             | \$4,126           | \$12,670          | \$3,041           | \$92,365   | \$7,167           |

The impairment of the investment portfolio amounted to \$4.2 million on securities with a total fair value of \$72.9 million at June 30, 2014. The most significant components of this impairment are related to the collateralized mortgage obligations and the trust preferred securities held in the portfolio. The unrealized losses on the CMO's are primarily related to the recent movement in market interest rates rather than the underlying credit quality of the issuers. The Company does not currently intend to sell these securities prior to their maturity or the recovery of their cost bases and does not believe it will be forced to sell these securities prior to maturity or recovering the cost bases.

At June 30, 2014, the investment portfolio included thirty collateralized mortgage obligations with a total market value of \$143.7 million. Fifteen of these securities carried an unrealized loss at June 30, 2014. At June 30, 2014, the investment portfolio included forty-two mortgage-backed securities with a total market value of \$14.2 million. Two of these securities carried an unrealized loss at June 30, 2014. Management found no evidence of OTTI on any of these securities and the unrealized losses are due to changes in fair value resulting from changes in market interest rates and are considered temporary as of June 30, 2014.

The unrealized losses on the trust preferred securities are primarily the result of the secondary market for such securities becoming inactive and are also considered temporary at this time.

The following table provides additional detail about trust preferred securities held in the portfolio as of June 30, 2014.

| (dollars in thousands)        | Class / Tranche | Amortized Cost  | Fair Value   | Unrealized Losses  | Lowest Credit Rating Assigned | Number of Banks Currently Performing | Deferrals / Defaults as % of Current Balance | Conditional Default Rates for 2014 and beyond | Cumulative OTTI Life to Date |
|-------------------------------|-----------------|-----------------|--------------|--------------------|-------------------------------|--------------------------------------|----------------------------------------------|-----------------------------------------------|------------------------------|
| Preferred Term Securities IV  | Mezzanine Notes | \$ 49           | \$ 40        | \$ (9 )            | B1                            | 6                                    | 18 %                                         | 0.34 %                                        | \$ -                         |
| Preferred Term Securities VII | Mezzanine Notes | 989             | 768          | (221 )             | D                             | 11                                   | 54                                           | 0.37                                          | 2,173                        |
| TPREF Funding II              | Class B Notes   | 732             | 350          | (382 )             | C                             | 17                                   | 41                                           | 0.39                                          | 267                          |
| TPREF Funding III             | Class B2 Notes  | 1,520           | 710          | (810 )             | C                             | 16                                   | 34                                           | 0.29                                          | 480                          |
| Trapeza CDO I, LLC            | Class C1 Notes  | 556             | 308          | (248 )             | C                             | 9                                    | 49                                           | 0.31                                          | 470                          |
| ALESCO Preferred Funding IV   | Class B1 Notes  | 604             | 387          | (217 )             | C                             | 40                                   | 8                                            | 0.36                                          | 396                          |
| ALESCO Preferred Funding V    | Class C1 Notes  | 820             | 414          | (406 )             | C                             | 41                                   | 15                                           | 0.33                                          | 180                          |
| <b>Total</b>                  |                 | <b>\$ 5,270</b> | <b>2,977</b> | <b>\$ (2,293 )</b> |                               | <b>140</b>                           | <b>30 %</b>                                  |                                               | <b>\$ 3,966</b>              |

At June 30, 2014, the investment portfolio included twenty-one municipal securities with a total market value of \$11.9 million. Two of these securities carried an unrealized loss at June 30, 2014. Each of the municipal securities is reviewed quarterly for impairment. Research on each issuer is completed to ensure the financial stability of the municipal entity. The largest geographic concentration was in Pennsylvania where ten municipal securities had a market value of \$5.9 million. As of June 30, 2014, management found no evidence of OTTI on any of the municipal securities held in the investment securities portfolio.

Subsequent to the period ended June 30, 2014, investment securities with a fair value of \$70.1 million that were previously classified as available-for-sale were transferred to the held-to-maturity category. Unrealized losses of \$1.2 million associated with the transferred securities will remain in other comprehensive income and be amortized as an adjustment to yield over the remaining life of those securities.

Note 6: Loans Receivable and Allowance for Loan Losses

The following table sets forth the Company's gross loans by major categories as of June 30, 2014, and December 31, 2013:

|                                   | June 30,<br>2014 | December<br>31,<br>2013 |
|-----------------------------------|------------------|-------------------------|
| (dollars in thousands)            |                  |                         |
| Commercial real estate            | \$353,458        | \$342,794               |
| Construction and land development | 31,224           | 23,977                  |
| Commercial and industrial         | 127,818          | 118,209                 |
| Owner occupied real estate        | 167,130          | 160,229                 |
| Consumer and other                | 37,255           | 31,981                  |
| Residential mortgage              | 2,330            | 2,359                   |
| Total loans receivable            | 719,215          | 679,549                 |
| Deferred costs (fees)             | (346 )           | (238 )                  |
| Allowance for loan losses         | (12,063 )        | (12,263 )               |
| Net loans receivable              | \$706,806        | \$667,048               |

A loan is considered impaired, when based on current information and events, it is probable that the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming loans, but also include internally classified accruing loans.

The following table summarizes information with regard to impaired loans by loan portfolio class as of June 30, 2014 and December 31, 2013:

| (dollars in thousands)              | June 30, 2014          |                                |                      | December 31, 2013      |                                |                      |
|-------------------------------------|------------------------|--------------------------------|----------------------|------------------------|--------------------------------|----------------------|
|                                     | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
| With no related allowance recorded: |                        |                                |                      |                        |                                |                      |
| Commercial real estate              | \$6,658                | \$6,662                        | \$-                  | \$6,850                | \$6,971                        | \$-                  |
| Construction and land development   | 593                    | 3,700                          | -                    | 902                    | 4,076                          | -                    |
| Commercial and industrial           | 3,018                  | 6,247                          | -                    | 2,043                  | 2,882                          | -                    |
| Owner occupied real estate          | 864                    | 1,183                          | -                    | 542                    | 862                            | -                    |
| Consumer and other                  | 446                    | 714                            | -                    | 453                    | 711                            | -                    |
| Total                               | \$11,579               | \$18,506                       | \$-                  | \$10,790               | \$15,502                       | \$-                  |
| With an allowance recorded:         |                        |                                |                      |                        |                                |                      |
| Commercial real estate              | \$13,401               | \$13,643                       | \$4,045              | \$13,044               | \$13,044                       | \$3,679              |
| Construction and land development   | 669                    | 3,908                          | 294                  | 716                    | 3,867                          | 237                  |
| Commercial and industrial           | 3,719                  | 4,350                          | 1,618                | 4,889                  | 7,634                          | 1,254                |
| Owner occupied real estate          | 3,518                  | 3,520                          | 424                  | 2,891                  | 2,891                          | 430                  |
| Consumer and other                  | -                      | -                              | -                    | 203                    | 210                            | 10                   |
| Total                               | \$21,307               | \$25,421                       | \$6,381              | \$21,743               | \$27,646                       | \$5,610              |
| Total:                              |                        |                                |                      |                        |                                |                      |
| Commercial real estate              | \$ 20,059              | \$ 20,305                      | \$ 4,045             | \$ 19,894              | \$ 20,015                      | \$ 3,679             |
| Construction and land development   | 1,262                  | 7,608                          | 294                  | 1,618                  | 7,943                          | 237                  |
| Commercial and industrial           | 6,737                  | 10,597                         | 1,618                | 6,932                  | 10,516                         | 1,254                |
| Owner occupied real estate          | 4,382                  | 4,703                          | 424                  | 3,433                  | 3,753                          | 430                  |
| Consumer and other                  | 446                    | 714                            | -                    | 656                    | 921                            | 10                   |
| Total                               | \$ 32,886              | \$ 43,927                      | \$ 6,381             | \$ 32,533              | \$ 43,148                      | \$ 5,610             |

The following table presents additional information regarding the Company's impaired loans for the three months ended June 30, 2014 and June 30, 2013:

|                                     | Three Months Ended June 30,       |                                  |                                   |                                  |       |
|-------------------------------------|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|-------|
|                                     | 2014                              |                                  | 2013                              |                                  |       |
| (dollars in thousands)              | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |       |
| With no related allowance recorded: |                                   |                                  |                                   |                                  |       |
| Commercial real estate              | \$ 6,696                          | \$ 106                           | \$ 15,343                         | \$ 202                           |       |
| Construction and land development   | 661                               | -                                | 1,822                             | 8                                |       |
| Commercial and industrial           | 2,859                             | -                                | 2,953                             | 5                                |       |
| Owner occupied real estate          | 802                               | (3 )                             | 180                               | -                                |       |
| Consumer and other                  | 480                               | -                                | 725                               | -                                |       |
| Total                               | \$ 11,498                         | \$ 103                           | \$ 21,023                         | \$ 215                           |       |
| With an allowance recorded:         |                                   |                                  |                                   |                                  |       |
| Commercial real estate              |                                   | \$13,325                         | \$(130 )                          | \$7,056                          | \$25  |
| Construction and land development   |                                   | 659                              | -                                 | 494                              | -     |
| Commercial and industrial           |                                   | 3,914                            | (1 )                              | 3,504                            | 14    |
| Owner occupied real estate          |                                   | 3,315                            | 35                                | 3,149                            | 37    |
| Consumer and other                  |                                   | 35                               | -                                 | 25                               | -     |
| Total                               |                                   | \$21,248                         | \$(96 )                           | \$14,228                         | \$76  |
| Total:                              |                                   |                                  |                                   |                                  |       |
| Commercial real estate              |                                   | \$20,021                         | \$(24 )                           | \$22,399                         | \$227 |
| Construction and land development   |                                   | 1,320                            | -                                 | 2,316                            | 8     |
| Commercial and industrial           |                                   | 6,773                            | (1 )                              | 6,457                            | 19    |
| Owner occupied real estate          |                                   | 4,117                            | 32                                | 3,329                            | 37    |
| Consumer and other                  |                                   | 515                              | -                                 | 750                              | -     |
| Total                               |                                   | \$32,746                         | \$7                               | \$35,251                         | \$291 |

If these loans were performing under their original contractual rate, interest income on such loans would have increased approximately \$399,000 and \$130,000 for the three months ended June 30, 2014 and 2013, respectively.

The following table presents additional information regarding the Company's impaired loans for the six months ended June 30, 2014 and June 30, 2013:

|                                     | Six Months Ended June 30,         |                                  |                                   |                                  |
|-------------------------------------|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|                                     | 2014                              |                                  | 2013                              |                                  |
| (dollars in thousands)              | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| With no related allowance recorded: |                                   |                                  |                                   |                                  |
| Commercial real estate              | \$6,734                           | \$ 212                           | \$17,766                          | \$ 421                           |
| Construction and land development   | 730                               | -                                | 2,615                             | 29                               |
| Commercial and industrial           | 2,699                             | 1                                | 2,935                             | 11                               |
| Owner occupied real estate          | 740                               | 2                                | 216                               | -                                |
| Consumer and other                  | 514                               | 1                                | 781                               | 1                                |
| Total                               | \$11,417                          | \$ 216                           | \$24,313                          | \$ 462                           |
| With an allowance recorded:         |                                   |                                  |                                   |                                  |
| Commercial real estate              | \$13,249                          | \$ 8                             | \$5,885                           | \$ 61                            |
| Construction and land development   | 650                               | -                                | 395                               | -                                |
| Commercial and industrial           | 4,111                             | -                                | 3,746                             | 28                               |
| Owner occupied real estate          | 3,113                             | 70                               | 3,295                             | 73                               |
| Consumer and other                  | 68                                | -                                | 49                                | -                                |
| Total                               | \$21,191                          | \$ 78                            | \$13,370                          | \$ 162                           |
| Total:                              |                                   |                                  |                                   |                                  |
| Commercial real estate              | \$19,983                          | \$ 220                           | \$23,651                          | \$ 482                           |
| Construction and land development   | 1,380                             | -                                | 3,010                             | 29                               |
| Commercial and industrial           | 6,810                             | 1                                | 6,681                             | 39                               |
| Owner occupied real estate          | 3,853                             | 72                               | 3,511                             | 73                               |
| Consumer and other                  | 582                               | 1                                | 830                               | 1                                |
| Total                               | \$32,608                          | \$ 294                           | \$37,683                          | \$ 624                           |

If these loans were performing under their original contractual rate, interest income on such loans would have increased approximately \$542,000 and \$339,000 for the six months ended June 30, 2014 and 2013, respectively.

The following tables provide the activity in and ending balances of the allowance for loan losses by loan portfolio class at and for the three and six months ended June 30, 2014 and 2013:

| (dollars in thousands)           | Commercial  |                      | Construction         | Commercial     | Owner Occupied |                 | Consumer       | Unallocated | Total |
|----------------------------------|-------------|----------------------|----------------------|----------------|----------------|-----------------|----------------|-------------|-------|
|                                  | Real Estate | and Land Development | and Land Development | and Industrial | Real Estate    | and Residential | Other Mortgage |             |       |
| Three months ended June 30, 2014 |             |                      |                      |                |                |                 |                |             |       |
| Allowance for loan losses:       |             |                      |                      |                |                |                 |                |             |       |
| Beginning balance:               | \$ 6,274    | \$ 861               | \$ 2,640             | \$ 1,128       | \$ 197         | \$ 13           | \$ 837         | \$ 11,950   |       |
| Charge-offs                      | (188 )      | -                    | -                    | -              | -              | -               | -              | (188 )      |       |
| Recoveries                       | -           | -                    | 1                    | -              | -              | -               | -              | 1           |       |
| Provisions (credits)             | 690         | 163                  | 150                  | 1              | 23             | -               | (727 )         | 300         |       |
| Ending balance                   | \$ 6,776    | \$ 1,024             | \$ 2,791             | \$ 1,129       | \$ 220         | \$ 13           | \$ 110         | \$ 12,063   |       |

Three months ended June 30, 2013  
Allowance for loan losses:

|                      |         |         |         |         |       |      |        |          |
|----------------------|---------|---------|---------|---------|-------|------|--------|----------|
| Beginning balance:   | \$3,257 | \$1,835 | \$2,336 | \$1,297 | \$170 | \$14 | \$444  | \$9,353  |
| Charge-offs          | (349 )  | -       | (361 )  | (319 )  | -     | -    | -      | (1,029 ) |
| Recoveries           | 54      | -       | 4       | -       | 25    | -    | -      | 83       |
| Provisions (credits) | 619     | 667     | 18      | 8       | (4 )  | -    | (383 ) | 925      |
| Ending balance       | \$3,581 | \$2,502 | \$1,997 | \$986   | \$191 | \$14 | \$61   | \$9,332  |

| (dollars in thousands)         | Commercial  |                      | Construction         | Commercial     | Owner Occupied |                 | Consumer       | Unallocated | Total |
|--------------------------------|-------------|----------------------|----------------------|----------------|----------------|-----------------|----------------|-------------|-------|
|                                | Real Estate | and Land Development | and Land Development | and Industrial | Real Estate    | and Residential | Other Mortgage |             |       |
| Six months ended June 30, 2014 |             |                      |                      |                |                |                 |                |             |       |
| Allowance for loan losses:     |             |                      |                      |                |                |                 |                |             |       |
| Beginning balance:             | \$ 6,454    | \$ 1,948             | \$ 2,309             | \$ 985         | \$ 225         | \$ 14           | \$ 328         | \$ 12,263   |       |
| Charge-offs                    | (188 )      | (20 )                | (283 )               | -              | (10 )          | -               | -              | (501 )      |       |
| Recoveries                     | -           | -                    | 1                    | -              | -              | -               | -              | 1           |       |
| Provisions (credits)           | 510         | (904 )               | 764                  | 144            | 5              | (1 )            | (218 )         | 300         |       |
| Ending balance                 | \$ 6,776    | \$ 1,024             | \$ 2,791             | \$ 1,129       | \$ 220         | \$ 13           | \$ 110         | \$ 12,063   |       |

Six months ended  
 June 30, 2013  
 Allowance for loan  
 losses:

|                      |         |         |         |         |       |      |        |          |
|----------------------|---------|---------|---------|---------|-------|------|--------|----------|
| Beginning Balance:   | \$3,979 | \$1,273 | \$1,880 | \$1,967 | \$234 | \$17 | \$192  | \$9,542  |
| Charge-offs          | (409 )  | (55 )   | (361 )  | (319 )  | (75 ) | -    | -      | (1,219 ) |
| Recoveries           | 54      | -       | 5       | -       | 25    | -    | -      | 84       |
| Provisions (credits) | (43 )   | 1,284   | 473     | (662 )  | 7     | (3 ) | (131 ) | 925      |
| Ending balance       | \$3,581 | \$2,502 | \$1,997 | \$986   | \$191 | \$14 | \$61   | \$9,332  |

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The following tables provide a summary of the allowance for loan losses and balance of loans receivable by loan class and by impairment method as of June 30, 2014 and December 31, 2013:

| (dollars in thousands)                | Commercial Real Estate | Construction and Land Development | Commercial and Industrial | Owner Occupied Real Estate | Consumer and Other | Residential Mortgage | Unallocated | Total     |
|---------------------------------------|------------------------|-----------------------------------|---------------------------|----------------------------|--------------------|----------------------|-------------|-----------|
| June 30, 2014                         |                        |                                   |                           |                            |                    |                      |             |           |
| Allowance for loan losses:            |                        |                                   |                           |                            |                    |                      |             |           |
| Individually evaluated for impairment | \$ 4,045               | \$ 294                            | \$ 1,618                  | \$ 424                     | \$ -               | \$ -                 | \$ -        | \$6,381   |
| Collectively evaluated for impairment | 2,731                  | 730                               | 1,173                     | 705                        | 220                | 13                   | 110         | 5,682     |
| Total allowance for loan losses       | \$ 6,776               | \$ 1,024                          | \$ 2,791                  | \$ 1,129                   | \$ 220             | \$ 13                | \$ 110      | \$12,063  |
| Loans receivable:                     |                        |                                   |                           |                            |                    |                      |             |           |
| Loans evaluated individually          | \$ 20,059              | \$ 1,262                          | \$ 6,737                  | \$ 4,382                   | \$ 446             | \$ -                 | \$ -        | \$32,886  |
| Loans evaluated collectively          | 333,399                | 29,962                            | 121,081                   | 162,748                    | 36,809             | 2,330                | -           | 686,329   |
| Total loans receivable                | \$ 353,458             | \$ 31,224                         | \$ 127,818                | \$ 167,130                 | \$ 37,255          | \$ 2,330             | \$ -        | \$719,215 |

| (dollars in thousands)                | Commercial Real Estate | Construction and Land Development | Commercial and Industrial | Owner Occupied Real Estate | Consumer and Other | Residential Mortgage | Unallocated | Total   |
|---------------------------------------|------------------------|-----------------------------------|---------------------------|----------------------------|--------------------|----------------------|-------------|---------|
| December 31, 2013                     |                        |                                   |                           |                            |                    |                      |             |         |
| Allowance for loan losses:            |                        |                                   |                           |                            |                    |                      |             |         |
| Individually evaluated for impairment | \$ 3,679               | \$ 237                            | \$ 1,254                  | \$ 430                     | \$ 10              | \$ -                 | \$ -        | \$5,610 |
| Collectively evaluated for impairment | 2,775                  | 1,711                             | 1,055                     | 555                        | 215                | 14                   | 328         | 6,653   |

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|                                    |            |           |            |            |           |          |        |           |
|------------------------------------|------------|-----------|------------|------------|-----------|----------|--------|-----------|
| Total allowance<br>for loan losses | \$ 6,454   | \$ 1,948  | \$ 2,309   | \$ 985     | \$ 225    | \$ 14    | \$ 328 | \$12,263  |
| Loans receivable:                  |            |           |            |            |           |          |        |           |
| Loans evaluated<br>individually    | \$ 19,894  | \$ 1,618  | \$ 6,932   | \$ 3,433   | \$ 656    | \$ -     | \$ -   | \$32,533  |
| Loans evaluated<br>collectively    | 322,900    | 22,359    | 111,277    | 156,796    | 31,325    | 2,359    | -      | 647,016   |
| Total loans<br>receivable          | \$ 342,794 | \$ 23,977 | \$ 118,209 | \$ 160,229 | \$ 31,981 | \$ 2,359 | \$ -   | \$679,549 |

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past due status as of June 30, 2014 and December 31, 2013:

| (dollars in thousands)                  | 30-59<br>Days Past<br>Due | 60-89<br>Days Past<br>Due | Greater<br>than 90<br>Days | Total<br>Past<br>Due | Current    | Total<br>Loans<br>Receivable | Loans<br>Receivable<br>> 90 Days<br>and<br>Accruing |
|-----------------------------------------|---------------------------|---------------------------|----------------------------|----------------------|------------|------------------------------|-----------------------------------------------------|
| At June 30, 2014                        |                           |                           |                            |                      |            |                              |                                                     |
| Commercial real estate                  | \$ -                      | \$ 13,865                 | \$ 14,741                  | \$ 28,606            | \$ 324,852 | \$ 353,458                   | \$ 524                                              |
| Construction and land development       | -                         | -                         | 1,262                      | 1,262                | 29,962     | 31,224                       | -                                                   |
| Commercial and industrial               | -                         | 422                       | 7,679                      | 8,101                | 119,717    | 127,818                      | 942                                                 |
| Owner occupied real estate              | -                         | -                         | 2,790                      | 2,790                | 164,340    | 167,130                      | 1,256                                               |
| Consumer and other Residential mortgage | 184                       | -                         | 446                        | 630                  | 36,625     | 37,255                       | -                                                   |
|                                         | -                         | -                         | -                          | -                    | 2,330      | 2,330                        | -                                                   |
| Total                                   | \$ 184                    | \$ 14,287                 | \$ 26,918                  | \$ 41,389            | \$ 677,826 | \$ 719,215                   | \$ 2,722                                            |
| At December 31, 2013                    |                           |                           |                            |                      |            |                              |                                                     |
| Commercial real estate                  | \$ 19,707                 | \$ 5,635                  | \$ 1,104                   | \$ 26,446            | \$ 316,348 | \$ 342,794                   | \$ -                                                |
| Construction and land development       | -                         | -                         | 1,618                      | 1,618                | 22,359     | 23,977                       | -                                                   |
| Commercial and industrial               | 951                       | 71                        | 6,837                      | 7,859                | 110,350    | 118,209                      | -                                                   |
| Owner occupied real estate              | 808                       | 1,281                     | 205                        | 2,294                | 157,935    | 160,229                      | -                                                   |
| Consumer and other Residential mortgage | 38                        | -                         | 656                        | 694                  | 31,287     | 31,981                       | -                                                   |
|                                         | -                         | -                         | -                          | -                    | 2,359      | 2,359                        | -                                                   |
| Total                                   | \$ 21,504                 | \$ 6,987                  | \$ 10,420                  | \$ 38,911            | \$ 640,638 | \$ 679,549                   | \$ -                                                |

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system as of June 30, 2014 and December 31, 2013:

| (dollars in thousands) | Pass       | Special<br>Mention | Substandard | Doubtful | Total      |
|------------------------|------------|--------------------|-------------|----------|------------|
| At June 30, 2014:      |            |                    |             |          |            |
| Commercial real estate | \$ 315,868 | \$ 16,989          | \$ 20,601   | \$ -     | \$ 353,458 |

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|                                   |           |          |          |     |           |
|-----------------------------------|-----------|----------|----------|-----|-----------|
| Construction and land development | 29,962    | -        | 1,262    | -   | 31,224    |
| Commercial and industrial         | 119,227   | 782      | 7,809    | -   | 127,818   |
| Owner occupied real estate        | 161,051   | 1,697    | 4,382    | -   | 167,130   |
| Consumer and other                | 36,476    | 75       | 704      | -   | 37,255    |
| Residential mortgage              | 2,330     | -        | -        | -   | 2,330     |
| Total                             | \$664,914 | \$19,543 | \$34,758 | \$- | \$719,215 |

| (dollars in thousands)            | Pass      | Special<br>Mention | Substandard | Doubtful | Total     |
|-----------------------------------|-----------|--------------------|-------------|----------|-----------|
| At December 31, 2013:             |           |                    |             |          |           |
| Commercial real estate            | \$305,974 | \$16,372           | \$20,448    | \$-      | \$342,794 |
| Construction and land development | 22,359    | -                  | 1,618       | -        | 23,977    |
| Commercial and industrial         | 110,629   | 611                | 6,969       | -        | 118,209   |
| Owner occupied real estate        | 155,648   | 1,485              | 3,096       | -        | 160,229   |
| Consumer and other                | 30,993    | 75                 | 913         | -        | 31,981    |
| Residential mortgage              | 2,359     | -                  | -           | -        | 2,359     |
| Total                             | \$627,962 | \$18,543           | \$33,044    | \$-      | \$679,549 |

The following table shows non-accrual loans by class as of June 30, 2014 and December 31, 2013:

| (dollars in thousands)            | June 30,<br>2014 | December 31,<br>2013 |
|-----------------------------------|------------------|----------------------|
| Commercial real estate            | \$ 14,217        | \$ 1,104             |
| Construction and land development | 1,262            | 1,618                |
| Commercial and industrial         | 6,737            | 6,837                |
| Owner occupied real estate        | 1,534            | 205                  |
| Consumer and other                | 446              | 656                  |
| Residential mortgage              | -                | -                    |
| Total                             | \$ 24,196        | \$ 10,420            |

### Troubled Debt Restructurings

A modification to the contractual terms of a loan which results in a concession to a borrower that is experiencing financial difficulty is classified as a troubled debt restructuring (“TDR”). The concessions made in a TDR are those that would not otherwise be considered for a borrower or collateral with similar risk characteristics. A TDR is typically the result of efforts to minimize potential losses that may be incurred during loan workouts, foreclosure, or repossession of collateral at a time when collateral values are declining. Concessions include a reduction in interest rate below current market rates, a material extension of time to the loan term or amortization period, partial forgiveness of the outstanding principal balance, acceptance of interest only payments for a period of time, or a combination of any of these conditions.

The following table summarizes the balance of outstanding TDRs June 30, 2014 and December 31, 2013:

| (dollars in thousands)            | Number<br>of Loans | Accrual<br>Status | Non-Accrual<br>Status | Total<br>TDRs |
|-----------------------------------|--------------------|-------------------|-----------------------|---------------|
| June 30, 2014                     |                    |                   |                       |               |
| Commercial real estate            | -                  | \$-               | \$-                   | \$-           |
| Construction and land development | -                  | -                 | -                     | -             |
| Commercial and industrial         | 1                  | -                 | 2,188                 | 2,188         |
| Owner occupied real estate        | 1                  | 1,877             | -                     | 1,877         |
| Consumer and other                | -                  | -                 | -                     | -             |
| Residential mortgage              | -                  | -                 | -                     | -             |
| Total                             | 2                  | \$1,877           | \$2,188               | \$4,065       |
| December 31, 2013                 |                    |                   |                       |               |
| Commercial real estate            | 1                  | \$103             | \$-                   | \$103         |
| Construction and land development | -                  | -                 | -                     | -             |
| Commercial and industrial         | 1                  | -                 | 2,188                 | 2,188         |
| Owner occupied real estate        | 1                  | 1,894             | -                     | 1,894         |
| Consumer and other                | -                  | -                 | -                     | -             |
| Residential mortgage              | -                  | -                 | -                     | -             |
| Total                             | 3                  | \$1,997           | \$2,188               | \$4,185       |

All TDRs are considered impaired and are therefore individually evaluated for impairment in the calculation of the allowance for loan losses. Some TDRs may not ultimately result in the full collection of principal and interest as restructured and could lead to potential incremental losses. These potential incremental losses would be factored into our estimate of the allowance for loan losses. The level of any subsequent defaults will likely be affected by future economic conditions. There were no loan modifications that were considered TDRs during the three and six months ended June 30, 2014 and 2013.

After a loan is determined to be a TDR, we continue to track its performance under the most recent restructured terms. One loan classified as a TDR subsequently paid off during the three months ended March 31, 2014. One loan classified as a TDR subsequently defaulted during the year ended December 31, 2013. There were no troubled debt restructurings that subsequently defaulted during the three and six months ended June 30, 2014 and 2013.

#### Note 7: Fair Value of Financial Instruments

Management uses its best judgment in estimating the fair value of the Company's financial instruments, however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sale transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

The Company follows the guidance issued under ASC 820, Fair Value Measurement, which defines fair value, establishes a framework for measuring fair value under GAAP, and identifies required disclosures on fair value measurements.

ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported with little or no market activity).

An asset or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2014 and December 31, 2013 were as follows:

| (dollars in thousands)              | Total      | (Level 1)<br>Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets | (Level 2)<br>Significant<br>Other<br>Observable<br>Inputs | (Level 3)<br>Significant<br>Unobservable<br>Inputs |
|-------------------------------------|------------|-------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
| June 30, 2014                       |            |                                                                                     |                                                           |                                                    |
| Collateralized mortgage obligations | \$ 143,723 | \$-                                                                                 | \$ 143,723                                                | \$ -                                               |
| Mortgage-backed securities          | 14,200     | -                                                                                   | 14,200                                                    | -                                                  |
| Municipal securities                | 11,944     | -                                                                                   | 11,944                                                    | -                                                  |
| Corporate bonds                     | 27,618     | -                                                                                   | 24,612                                                    | 3,006                                              |
| Asset-backed securities             | 19,047     | -                                                                                   | 19,047                                                    | -                                                  |
| Trust Preferred Securities          | 2,977      | -                                                                                   | -                                                         | 2,977                                              |
| Other securities                    | 125        | -                                                                                   | 125                                                       | -                                                  |
| Securities Available for Sale       | \$ 219,634 | \$-                                                                                 | \$ 213,651                                                | \$ 5,983                                           |
| December 31, 2013                   |            |                                                                                     |                                                           |                                                    |
| Collateralized mortgage obligations | \$ 123,440 | \$-                                                                                 | \$ 123,440                                                | \$-                                                |
| Mortgage-backed securities          | 16,181     | -                                                                                   | 16,181                                                    | -                                                  |
| Municipal securities                | 9,643      | -                                                                                   | 9,643                                                     | -                                                  |
| Corporate bonds                     | 33,253     | -                                                                                   | 30,247                                                    | 3,006                                              |
| Asset-backed securities             | 19,407     | -                                                                                   | 19,407                                                    | -                                                  |
| Trust Preferred Securities          | 2,850      | -                                                                                   | -                                                         | 2,850                                              |
| Other securities                    | 117        | -                                                                                   | 117                                                       | -                                                  |
| Securities Available for Sale       | \$ 204,891 | \$-                                                                                 | \$ 199,035                                                | \$ 5,856                                           |

The following table presents a reconciliation of the securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2014 and 2013:

|                                                    | Three Months Ended<br>June 30, 2014 |                    | Three Months Ended<br>June 30, 2013 |                    |
|----------------------------------------------------|-------------------------------------|--------------------|-------------------------------------|--------------------|
|                                                    | Trust                               |                    | Trust                               |                    |
|                                                    | Preferred<br>Securities             | Corporate<br>Bonds | Preferred<br>Securities             | Corporate<br>Bonds |
| Level 3 Investments Only<br>(dollars in thousands) |                                     |                    |                                     |                    |
| Balance, April 1st                                 | \$2,807                             | \$3,006            | \$3,238                             | \$3,007            |
| Unrealized gains (losses)                          | 177                                 | -                  | (65 )                               | (1 )               |
| Paydowns                                           | -                                   | -                  | (11 )                               | -                  |
| Impairment charges on Level 3                      | (7 )                                | -                  | -                                   | -                  |
| Balance, June 30th                                 | \$2,977                             | \$3,006            | \$3,162                             | \$3,006            |

|                                                    | Six Months Ended<br>June 30, 2014 |                    | Six Months Ended<br>June 30, 2013 |                    |
|----------------------------------------------------|-----------------------------------|--------------------|-----------------------------------|--------------------|
|                                                    | Trust                             |                    | Trust                             |                    |
|                                                    | Preferred<br>Securities           | Corporate<br>Bonds | Preferred<br>Securities           | Corporate<br>Bonds |
| Level 3 Investments Only<br>(dollars in thousands) |                                   |                    |                                   |                    |
| Balance, January 1st                               | \$2,850                           | \$3,006            | \$3,187                           | \$3,007            |
| Unrealized gains (losses)                          | 134                               | -                  | (7 )                              | (1 )               |
| Paydowns                                           | -                                 | -                  | (18 )                             | -                  |
| Impairment charges on Level 3                      | (7 )                              | -                  | -                                 | -                  |
| Balance, June 30th                                 | \$2,977                           | \$3,006            | \$3,162                           | \$3,006            |

For assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2014 and December 31, 2013 were as follows:

| (dollars in thousands)  | Total    | (Level 1)<br>Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets |     | (Level 2)<br>Significant<br>Other<br>Observable<br>Inputs | (Level 3)<br>Significant<br>Unobservable<br>Inputs |
|-------------------------|----------|-------------------------------------------------------------------------------------|-----|-----------------------------------------------------------|----------------------------------------------------|
|                         |          |                                                                                     |     |                                                           |                                                    |
| June 30, 2014:          |          |                                                                                     |     |                                                           |                                                    |
| Impaired loans          | \$16,355 | \$-                                                                                 | \$- |                                                           | \$ 16,355                                          |
| Other real estate owned | 1,059    | -                                                                                   | -   |                                                           | 1,059                                              |
| SBA servicing assets    | 4,067    | -                                                                                   | -   |                                                           | 4,067                                              |
| December 31, 2013:      |          |                                                                                     |     |                                                           |                                                    |
| Impaired loans          | \$17,474 | \$-                                                                                 | \$- |                                                           | \$ 17,474                                          |
| Other real estate owned | 3,921    | -                                                                                   | -   |                                                           | 3,921                                              |
| SBA servicing assets    | 3,477    | -                                                                                   | -   |                                                           | 3,477                                              |



The table below presents additional quantitative information about level 3 assets measured at fair value on a nonrecurring basis (dollars in thousands):

Quantitative Information about Level 3 Fair Value Measurements

| Asset Description       | Fair Value | Valuation Technique          | Unobservable Input                                    | Range Weighted Average |
|-------------------------|------------|------------------------------|-------------------------------------------------------|------------------------|
| June 30, 2014:          |            |                              |                                                       |                        |
| Impaired loans          | \$ 16,355  | Fair Value of Collateral (1) | Appraised Value (2)                                   | 0% - 78% (29%) (4)     |
| Other real estate owned | \$ 1,059   | Fair Value of Collateral (1) | Appraised Value (2)<br>Sales Price<br>Individual Loan | 8% - 38% (33%)(4)      |
| SBA Servicing Assets    | \$ 4,067   | Fair Value                   | Valuation (3)                                         | (3)                    |
| December 31, 2013:      |            |                              |                                                       |                        |
| Impaired loans          | \$ 17,474  | Fair Value of Collateral (1) | Appraised Value (2)                                   | 0% - 40% (23%) (4)     |
| Other real estate owned | \$ 3,921   | Fair Value of Collateral (1) | Appraised Value (2)<br>Sales Price<br>Individual Loan | 4% - 77% (17%) (4)     |
| SBA Servicing Assets    | \$ 3,477   | Fair Value                   | Valuation (3)                                         | (3)                    |

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which include Level 3 inputs that are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses.

(3) There is a lack of transactional data in this market place for the non-guaranteed portion of SBA loans.

(4) The range and weighted average of qualitative factors such as economic conditions and estimated liquidation expenses are presented as a percent of the appraised value.

The significant unobservable inputs for impaired loans and other real estate owned are the appraised value or an agreed upon sales price. These values are adjusted for estimated costs to sell which are incremental direct costs to transact a sale such as broker commissions, legal fees, closing costs and title transfer fees. The costs must be considered essential to the sale and would not have been incurred if the decision to sell had not been made. The costs to sell are based on costs associated with the Company's actual sales of other real estate owned which are assessed annually.

The following table presents an analysis of the activity in the SBA servicing assets for the three and six months ended June 30, 2014 and 2013:

| (dollars in thousands) | Three Months Ended June 30, | Six Months Ended June 30, |
|------------------------|-----------------------------|---------------------------|
|------------------------|-----------------------------|---------------------------|

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|                        | 2014    | 2013    | 2014    | 2013    |
|------------------------|---------|---------|---------|---------|
| Beginning balance      | \$3,805 | \$2,491 | \$3,477 | \$2,340 |
| Additions              | 271     | 482     | 575     | 628     |
| Fair value adjustments | (9 )    | (69 )   | 15      | (64 )   |
| Ending balance         | \$4,067 | \$2,904 | \$4,067 | \$2,904 |

## Fair Value Assumptions

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at June 30, 2014 and December 31, 2013.

### Cash and Cash Equivalents (Carried at Cost)

The carrying amounts reported in the balance sheet for cash and cash equivalents approximate those assets' fair values.

### Investment Securities

The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities, which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments, are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) were used to support fair values of certain Level 3 investments.

The types of instruments valued based on matrix pricing in active markets include all of the Company's U.S. government and agency securities, corporate bonds, asset backed securities, and municipal obligations. Such instruments are generally classified within Level 2 of the fair value hierarchy. As required by ASC 820-10, the Company does not adjust the matrix pricing for such instruments.

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, and may be adjusted to reflect illiquidity and/or non-transferability, with such adjustment generally based on available market evidence. In the absence of such evidence, management's best estimate is used. Subsequent to inception, management only changes Level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows. The Level 3 investment securities classified as available for sale are comprised of various issues of trust preferred securities and a single corporate bond.

The trust preferred securities are pools of similar securities that are grouped into an asset structure commonly referred to as collateralized debt obligations ("CDOs") which consist of the debt instruments of various banks, diversified by the number of participants in the security as well as geographically. The secondary market for these securities has become inactive, and therefore these securities are classified as Level 3 securities. The fair value analysis does not reflect or represent the actual terms or prices at which any party could purchase the securities. There is currently a limited secondary market for the securities and there can be no assurance that any secondary market for the securities will expand.



An independent, third party pricing service is used to estimate the current fair market value of each CDO held in the investment securities portfolio. The calculations used to determine fair value are based on the attributes of the trust preferred securities, the financial condition of the issuers of the trust preferred securities, and market based assumptions. The INTEX CDO Deal Model Library was utilized to obtain information regarding the attributes of each security and its specific collateral as of June 30, 2014 and December 31, 2013. Financial information on the issuers was also obtained from Bloomberg, the FDIC, the Office of Thrift Supervision and SNL Financial. Both published and unpublished industry sources were utilized in estimating fair value. Such information includes loan prepayment speed assumptions, discount rates, default rates, and loss severity percentages. Due to the current state of the global capital and financial markets, the fair market valuation is subject to greater uncertainty than would otherwise exist.

The fair market valuation for each CDO was determined based on discounted cash flow analyses. The cash flows are primarily dependent on the estimated speeds at which the trust preferred securities are expected to prepay, the estimated rates at which the trust preferred securities are expected to defer payments, the estimated rates at which the trust preferred securities are expected to default, and the severity of the losses on securities that do default.

Increases (decreases) in actual or expected issuer defaults tend to decrease (increase) the fair value of the Company's senior and mezzanine tranches of CDOs. The values of the Company's mezzanine tranches of CDOs are also affected by expected future interest rates. However, due to the structure of each security, timing of cash flows, and secondary effects on the financial performance of the underlying issuers, the effects of changes in future interest rates on the fair value of the Company's holdings are not quantifiably estimable.

Also included in Level 3 investment securities classified as available for sale is a single-issuer corporate bond since the bond is not actively traded. Impairment would depend on the repayment ability of the underlying issuer, which is assessed through a detailed quarterly review of the issuer's financial statements. The issuer is a "well capitalized" financial institution as defined by federal banking regulations and has demonstrated the ability to raise additional capital, when necessary, through the public capital markets. The fair value of this corporate bond is estimated by obtaining a price of a comparable floating rate debt instrument through Bloomberg.

#### Loans Held For Sale (Carried at Lower of Cost or Fair Value)

The fair values of loans held for sale is determined, when possible, using quoted secondary-market prices. If no such quoted prices exist, the fair value of a loan is determined using quoted prices for a similar loan or loans, adjusted for the specific attributes of that loan. The Company did not write down any loans held for sale during the six months ended June 30, 2014 and the year ended December 31, 2013.

#### Loans Receivable (Carried at Cost)

The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Due to the significant judgment involved in evaluating credit quality, loans are classified within Level 3 of the fair value hierarchy.

#### Impaired Loans (Carried at Lower of Cost or Fair Value)

Impaired loans are those that the Company has measured impairment based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances less any valuation allowance. The valuation allowance amount is calculated as the difference between the recorded investment in a loan and the present value of expected future cash flows or it is calculated based on discounted collateral values if the loans are collateral dependent.

## Other Real Estate Owned (Carried at Lower of Cost or Fair Value)

These assets are carried at the lower of cost or fair value. At June 30, 2014 and December 31, 2013 these assets are carried at current fair value.

## SBA Servicing Asset (Carried at Fair Value)

The SBA servicing asset is initially recorded when loans are sold and the servicing rights are retained and recorded on the balance sheet. Updated fair values are obtained on a quarterly basis and adjustments are presented as loan advisory and servicing fees on the consolidated statement of income. The valuation begins with the projection of future cash flows for each asset based on their unique characteristics, our market-based assumptions for prepayment speeds and estimated losses and recoveries. The present value of the future cash flows are then calculated utilizing our market-based discount ratio assumptions. In all cases, we model expected payments for every loan for each quarterly period in order to create the most detailed cash flow stream possible.

The Company uses assumptions and estimates in determining the impairment of the SBA servicing asset. These assumptions include prepayment speeds and discount rates commensurate with the risks involved and comparable to assumptions used by participants to value and bid serving rights available for sale in the market. At June 30, 2014 and December 31, 2013, the sensitivity of the current fair value of the SBA loan servicing rights to immediate 10% and 20% adverse changes in key assumptions are included in the accompanying table.

| (dollars in thousands)                       | June 30,<br>2014 |   | December<br>31,<br>2013 |            |
|----------------------------------------------|------------------|---|-------------------------|------------|
| SBA Servicing Asset                          |                  |   |                         |            |
| Fair Value of SBA Servicing Asset            | \$4,067          |   | \$3,477                 |            |
| Composition of SBA Loans Serviced for Others |                  |   |                         |            |
| Fixed-rate SBA loans                         | 0                | % | 0                       | %          |
| Adjustable-rate SBA loans                    | 100              | % | 100                     | %          |
| Total                                        | 100              | % | 100                     | %          |
| Weighted Average Remaining Term              |                  |   | 21.1 years              | 21.4 years |
| Prepayment Speed                             | 6.99             | % | 6.72                    | %          |
| Effect on fair value of a 10% increase       | \$(111)          | ) | \$(83)                  | )          |
| Effect on fair value of a 20% increase       | (218)            | ) | (163)                   | )          |
| Weighted Average Discount Rate               | 11.59            | % | 13.59                   | %          |
| Effect on fair value of a 10% increase       | \$(203)          | ) | \$(162)                 | )          |
| Effect on fair value of a 20% increase       | (391)            | ) | (316)                   | )          |

The sensitivity calculations above are hypothetical and should not be considered to be predictive of future performance. As indicated, changes in value based on adverse changes in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in value may not be linear. Also in this table, the effect of an adverse variation in a particular assumption on the value of the SBA servicing rights is calculated without changing any other assumption. While in reality, changes in one factor may magnify or counteract

the effect of the change.

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Restricted Stock (Carried at Cost)

The carrying amount of restricted stock approximates fair value, and considers the limited marketability of such securities.

Accrued Interest Receivable and Payable (Carried at Cost)

The carrying amount of accrued interest receivable and accrued interest payable approximates fair value.

Deposit Liabilities (Carried at Cost)

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Subordinated Debt (Carried at Cost)

Fair values of subordinated debt are estimated using discounted cash flow analysis, based on market rates currently offered on such debt with similar credit risk characteristics, terms and remaining maturity. Due to the significant judgment involved in developing the spreads used to value the subordinated debt, it is classified within level 3 of the fair value hierarchy.

Off-Balance Sheet Financial Instruments (Disclosed at notional amounts)

Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

The estimated fair values of the Company's financial instruments were as follows at June 30, 2014 and December 31, 2013:

| (dollars in thousands)                   | Fair Value Measurements at June 30, 2014 |            |                                                                |                                               |                                           |
|------------------------------------------|------------------------------------------|------------|----------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|
|                                          | Carrying Amount                          | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Balance Sheet Data                       |                                          |            |                                                                |                                               |                                           |
| Financial assets:                        |                                          |            |                                                                |                                               |                                           |
| Cash and cash equivalents                | \$ 83,120                                | \$ 83,120  | \$ 83,120                                                      | \$ -                                          | \$ -                                      |
| Investment securities available for sale | 219,634                                  | 219,634    | -                                                              | 213,651                                       | 5,983                                     |
| Investment securities held to maturity   | 21                                       | 21         | -                                                              | 21                                            | -                                         |
| Restricted stock                         | 1,725                                    | 1,725      | -                                                              | 1,725                                         | -                                         |
| Loans held for sale                      | 491                                      | 491        | -                                                              | -                                             | 491                                       |
| Loans receivable, net                    | 706,806                                  | 699,188    | -                                                              | -                                             | 699,188                                   |
| SBA servicing assets                     | 4,067                                    | 4,067      | -                                                              | -                                             | 4,067                                     |
| Accrued interest receivable              | 3,104                                    | 3,104      | -                                                              | 3,104                                         | -                                         |
| Financial liabilities:                   |                                          |            |                                                                |                                               |                                           |
| Deposits                                 |                                          |            |                                                                |                                               |                                           |
| Demand, savings and money market         | \$ 843,875                               | \$ 843,875 | \$ -                                                           | \$ 843,875                                    | \$ -                                      |
| Time                                     | 80,809                                   | 81,235     | -                                                              | 81,235                                        | -                                         |
| Subordinated debt                        | 22,476                                   | 18,224     | -                                                              | -                                             | 18,224                                    |
| Accrued interest payable                 | 292                                      | 292        | -                                                              | 292                                           | -                                         |
| Off-Balance Sheet Data                   |                                          |            |                                                                |                                               |                                           |
| Commitments to extend credit             | -                                        | -          | -                                                              | -                                             | -                                         |
| Standby letters-of-credit                | -                                        | -          | -                                                              | -                                             | -                                         |

| (dollars in thousands) | Fair Value Measurements at December 31, 2013 |            |                                                                |                                               |                                           |
|------------------------|----------------------------------------------|------------|----------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|
|                        | Carrying Amount                              | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Balance Sheet Data     |                                              |            |                                                                |                                               |                                           |
| Financial assets:      |                                              |            |                                                                |                                               |                                           |

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|                                          |           |           |          |           |         |
|------------------------------------------|-----------|-----------|----------|-----------|---------|
| Cash and cash equivalents                | \$35,880  | \$35,880  | \$35,880 | \$-       | \$ -    |
| Investment securities available for sale | 204,891   | 204,891   | -        | 199,035   | 5,856   |
| Investment securities held to maturity   | 21        | 21        | -        | 21        | -       |
| Restricted stock                         | 1,570     | 1,570     | -        | 1,570     | -       |
| Loans held for sale                      | 4,931     | 5,225     | -        | -         | 5,225   |
| Loans receivable, net                    | 667,048   | 660,237   | -        | -         | 660,237 |
| SBA servicing assets                     | 3,477     | 3,477     | -        | -         | 3,477   |
| Accrued interest receivable              | 3,049     | 3,049     | -        | 3,049     | -       |
| Financial liabilities:                   |           |           |          |           |         |
| Deposits                                 |           |           |          |           |         |
| Demand, savings and money market         | \$790,698 | \$790,698 | \$-      | \$790,698 | \$ -    |
| Time                                     | 78,836    | 79,323    | -        | 79,323    | -       |
| Subordinated debt                        | 22,476    | 17,835    | -        | -         | 17,835  |
| Accrued interest payable                 | 237       | 237       | -        | 237       | -       |
| Off-Balance Sheet Data                   |           |           |          |           |         |
| Commitments to extend credit             | -         | -         | -        | -         | -       |
| Standby letters-of-credit                | -         | -         | -        | -         | -       |

## ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is management's discussion and analysis of the Company's financial condition, changes in financial condition, and results of operations in the accompanying consolidated financial statements. This discussion should be read in conjunction with the accompanying notes to the consolidated financial statements.

Certain statements in this report may be considered to be "forward-looking statements" as that term is defined in the U.S. Private Securities Litigation Reform Act of 1995, such as statements that include the words "would be," "could be," "should be," "probability," "risk," "target," "objective," "may," "will," "estimate," "project," "believe," "intend," "anticipate," and similar expressions or variations on such expressions. The forward-looking statements contained herein are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. For example, risks and uncertainties can arise with changes in: general economic conditions, including turmoil in the financial markets and related efforts of government agencies to stabilize the financial system; business conditions in the financial services industry, including competitive pressure among financial services companies, new service and product offerings by competitors, price pressures and similar items. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. The Company undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date hereof, except as may be required by applicable laws or regulations. Readers should carefully review the risk factors described in the Form 10-K for the year ended December 31, 2013 and other documents the Company files from time to time with the SEC, such as Quarterly Reports on Form 10-Q, and any Current Reports on Form 8-K, as well as other filings.

### Regulatory Reform and Legislation

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") has and will continue to have a broad impact on the financial services industry, including significant regulatory and compliance changes including, among other things, (i) enhanced resolution authority of troubled and failing banks and their holding companies; (ii) increased capital and liquidity requirements; (iii) increased regulatory examination fees; (iv) changes to assessments to be paid to the FDIC for federal deposit insurance; and (v) numerous other provisions designed to improve supervision and oversight of, and strengthening safety and soundness for, the financial services sector. Additionally, the Dodd-Frank Act establishes a new framework for systemic risk oversight within the financial system to be distributed among new and existing federal regulatory agencies, including the Financial Stability Oversight Council, the Consumer Financial Protection Bureau, the Federal Reserve, the Office of the Comptroller of the Currency, and the FDIC. A summary of certain provisions of the Dodd-Frank Act is set forth in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

Many of the requirements called for in the Dodd-Frank Act will be implemented over time, and most are subject to implementing regulations that have or will become effective over the course of several years. Given the complexity associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies through regulations, the full extent of the impact such requirements will have on financial institutions' operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of the Company's business activities, require changes to certain of the Company's business practices, impose upon the Company more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect the Company's business. These changes may also require the Company to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.



In July 2013, the federal bank regulatory agencies adopted revisions to the agencies' capital adequacy guidelines and prompt corrective action rules, which were designed to enhance such requirements and implement the revised standards of the Basel Committee on Banking Supervision, commonly referred to as Basel III. The final rules generally implement higher minimum capital requirements, add a new common equity tier 1 capital requirement, and establish criteria that instruments must meet to be considered common equity tier 1 capital, additional tier 1 capital or tier 2 capital. The new minimum capital to risk-adjusted assets requirements are a common equity tier 1 capital ratio of 4.5% (6.5% to be considered "well capitalized") and a tier 1 capital ratio of 6.0%, increased from 4.0% (and increased from 6.0% to 8.0% to be considered "well capitalized"); the total capital ratio remains at 8.0% under the new rules (10.0% to be considered "well capitalized"). Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity tier 1 capital above its minimum risk-based capital requirements in an amount greater than 2.5% of total risk-weighted assets. The new minimum capital requirements are effective on January 1, 2015. The capital contribution buffer requirements phase in over a three-year period beginning January 1, 2016.

The Company and the Bank will continue to analyze these new rules and their effects on the business, operations and capital levels of the Company and the Bank. The Company and the Bank expect to be considered "well capitalized" immediately following effectiveness of these regulations.

## Financial Condition

### Assets

Total assets increased by \$103.5 million, or 10.8%, to \$1.1 billion at June 30, 2014, compared to \$961.7 million at December 31, 2013, mainly due to increases in loan, deposit, and shareholders' equity balances during the first six months of 2014.

### Cash and Cash Equivalents

Cash and due from banks and interest bearing deposits comprise this category, which consists of our most liquid assets. The aggregate amount in these two categories increased by \$47.2 million, to \$83.1 million at June 30, 2014, from \$35.9 million at December 31, 2013.

### Loans Held for Sale

Loans held for sale are comprised of loans guaranteed by the U.S. Small Business Administration ("SBA") which the Company usually originates with the intention of selling in the future. Total SBA loans held for sale were \$491,000 at June 30, 2014 as compared to \$4.9 million at December 31, 2013. This decrease was driven by the timing of settlement on two loans which closed shortly after December 31, 2013. Loans held for sale, as a percentage of total Company assets, were less than 0.1% at June 30, 2014.

### Loans Receivable

The loan portfolio represents our largest asset category and is our most significant source of interest income. Our lending strategy is focused on small and medium size businesses and professionals that seek highly personalized banking services. The loan portfolio consists of secured and unsecured commercial loans including commercial real estate, construction loans, residential mortgages, automobile loans, home improvement loans, home equity loans and

lines of credit, overdraft lines of credit and others. Commercial loans typically range between \$250,000 and \$5,000,000 but customers may borrow significantly larger amounts up to our legal lending limit to a customer, which was approximately \$18.2 million at June 30, 2014. Loans made to one individual customer, even if secured by different collateral, are aggregated for purposes of the lending limit.

Loans increased \$39.6 million, or 5.8%, to \$718.9 million at June 30, 2014, compared to \$679.3 million at December 31, 2013. This growth was driven by an increase in quality loan demand across all categories over the first six months of 2014 along with the successful execution of the Company's relationship banking strategy which focuses on customer service.

#### Investment Securities

Investment securities considered available-for-sale are investments which may be sold in response to changing market and interest rate conditions, and for liquidity and other purposes. Our investment securities classified as available-for-sale consist primarily of U.S. Government agency collateralized mortgage obligations (CMO), agency mortgage-backed securities (MBS), municipal securities, corporate bonds, asset-backed securities (ABS), and pooled trust preferred securities (CDO). Available-for-sale securities totaled \$219.6 million at June 30, 2014, compared to \$204.9 million at December 31, 2013. The increase was primarily due to the purchase of securities totaling \$31.4 million, partially offset by the proceeds from sales and pay downs of securities totaling \$20.0 million during the first six months of 2014. At June 30, 2014, the portfolio had a net unrealized loss of \$1.2 million compared to a net unrealized loss of \$4.4 million at December 31, 2013. The change in value of the investment portfolio was driven by a decrease in market interest rates which drove an increase in value of the bonds held in the Company's portfolio during the first six months of 2014.

Investment securities held-to-maturity are investments for which there is the intent and ability to hold the investment to maturity. These investments are carried at amortized cost. The held-to-maturity portfolio consists primarily of debt securities. At June 30, 2014 and December 31, 2013, securities held to maturity totaled \$21,000. At both dates, respective carrying values approximated market values.

#### Restricted Stock

Restricted stock, which represents required investment in the capital stock of correspondent banks related to available credit facilities, is carried at cost as of June 30, 2014 and December 31, 2013. As of those dates, restricted stock consisted of investments in the capital stock of the Federal Home Loan Bank of Pittsburgh ("FHLB") and Atlantic Central Bankers Bank ("ACBB").

At June 30, 2014, the investment in FHLB of Pittsburgh capital stock totaled \$1.6 million, compared to \$1.4 million at December 31, 2013. At both June 30, 2014 and December 31, 2013, ACBB capital stock totaled \$143,000. Both the FHLB and ACBB issued dividend payments during 2014.

#### Other Real Estate Owned

The balance of other real estate owned decreased to \$3.6 million at June 30, 2014 from \$4.1 million at December 31, 2013, primarily due to writedowns on one foreclosed property during the first six months of 2014.

#### Deposits

Deposits, which include non-interest and interest-bearing demand deposits, money market, savings and time deposits, are Republic's major source of funding. Deposits are generally solicited from the Company's market area through the offering of a variety of products to attract and retain customers, with a primary focus on multi-product relationships.

Total deposits increased by \$55.2 million, or 6.3%, to \$924.7 million at June 30, 2014 from \$869.5 million at December 31, 2013. The increase was primarily the result of increases in noninterest-bearing demand deposit

balances and money market and savings balances partially offset by a reduction in interest-bearing demand deposit balances. Republic has continued to focus on its efforts to gather low-cost, core deposits by successfully executing its relationship banking model which is based upon high levels of customer service. In addition, the Company has begun to implement its relocation and expansion strategy through the opening of additional stores. This strategy has also allowed Republic to reduce its dependence on the more volatile sources of funding in brokered and public fund certificates of deposit.

## Shareholders' Equity

Total shareholders' equity increased \$48.5 million to \$111.4 million at June 30, 2014, compared to \$62.9 million at December 31, 2013, primarily due to \$45.0 million in proceeds received from the sale of common stock in a private placement offering. In addition, there was also a reduction in accumulated other comprehensive losses associated with unrealized losses in the investment securities portfolio and net income recognized during the first six months of 2014. The shift in market value of the securities portfolio resulted in accumulated other comprehensive losses of \$767,000 at June 30, 2014 compared to accumulated other comprehensive losses of \$2.8 million at December 31, 2013 which was primarily driven by a decrease in market interest rates which drove an increase in value of the bonds held in the Company's portfolio.

## Results of Operations

### Three Months Ended June 30, 2014 Compared to Three Months Ended June 30, 2013

The Company reported net income of \$537,000, or \$0.02 per share, for the three months ended June 30, 2014, compared to net income of \$1.0 million, or \$0.04 per share, for the three months ended June 30, 2013. The decrease in net income was primarily driven by a decrease in gains recognized on the sale of SBA loans during the current period.

Net interest income for the three month period ended June 30, 2014 was \$8.5 million compared to \$8.1 million for the three months ended June 30, 2013. Interest income increased \$416,000, or 4.5%, to \$9.6 million for the three months ended June 30, 2014 compared to \$9.2 million for the three months ended June 30, 2013. This increase was primarily due to a \$73.1 million increase in average loan balances and a \$25.5 million increase in average investment securities balances. Interest expense increased \$30,000, or 2.3%, to \$1.1 million for the three months ended June 30, 2014 compared to \$1.1 million for the three months ended June 30, 2013. This increase was primarily due to an increase in average deposits outstanding.

The Company recorded a loan loss provision in the amount of \$300,000 for the three months ended June 30, 2014 compared to a provision of \$925,000 during the three months ended June 30, 2013. The lower provision recorded for the three months ended June 30, 2014 was driven by a reduction in the allowance for loan losses related to non-impaired loans evaluated collectively for impairment when compared to June 30, 2013.

Non-interest income decreased by \$581,000 to \$2.3 million during the three months ended June 30, 2014 compared to \$2.9 million during the three months ended June 30, 2013. The Company recognized \$1.0 million in gains on the sale of SBA loans for the three months ended June 30, 2014 compared to \$2.1 million for the three months ended June 30, 2013 as a result of fewer SBA loan originations during the current period. These were partially offset by gains on the sale of investment securities totaling \$458,000 recognized during the three months ended June 30, 2014.

Non-interest expenses increased \$901,000 to \$10.0 million during the three months ended June 30, 2014 compared to \$9.1 million during the three months ended June 30, 2013 mainly due to increased salary and benefit costs along with higher occupancy expenses related to the Company's growth strategy of adding and relocating stores.

Return on average assets and average equity was 0.21% and 2.14%, respectively, during the three months ended June 30, 2014 compared to 0.44% and 5.77%, respectively, for the three months ended June 30, 2013.



### Six Months Ended June 30, 2014 compared to June 30, 2013

The Company reported net income of \$1.3 million, or \$0.04 per share, for the six months ended June 30, 2014 compared to net income of \$2.0 million, or \$0.08 per share, for the six months ended June 30, 2013. The decrease in net income was primarily driven by a decrease in gains recognized on the sale of SBA loans during the current period.

Net interest income for the six months ended June 30, 2014 increased \$1.1 million to \$17.1 million as compared to \$16.0 million for the six months ended June 30, 2013. Interest income increased \$964,000, or 5.3%, due to increases in average loan balances and average investment securities balances. Interest expense decreased \$168,000, or 7.1%, primarily due to a 7 basis point decrease in the rate on average deposits outstanding.

The Company recorded a loan loss provision in the amount of \$300,000 for the six months ended June 30, 2014 compared to a provision of \$925,000 during the six months ended June 30, 2013. The lower provision recorded for the six months ended June 30, 2014 was driven by a reduction in the allowance for loan losses related to non-impaired loans evaluated collectively for impairment when compared to June 30, 2013.

Non-interest income decreased \$894,000 to \$4.2 million during the six months ended June 30, 2014 as compared to \$5.1 million during the six months ended June 30, 2013 primarily due to a decrease in gains recognized on the sale of SBA loans during the six months ended June 30, 2014 as a result of fewer SBA loan originations during the current period.

Non-interest expenses increased \$1.6 million to \$19.8 million during the six months ended June 30, 2014 as compared to \$18.2 million during the six months ended June 30, 2013. An increase in salaries and benefits of \$1.1 million was driven primarily by annual merit increases along with increased staffing levels related to the Company's growth strategy of adding and relocating stores. Occupancy related expenses also increased by \$459,000 as a result of the growth and relocation strategy.

Return on average assets and average equity from continuing operations were 0.26% and 3.16%, respectively, during the six months ended June 30, 2014 compared to 0.43% and 5.77%, respectively, for the six months ended June 30, 2013.

### Analysis of Net Interest Income

Historically, the Company's earnings have depended primarily upon Republic's net interest income, which is the difference between interest earned on interest-earning assets and interest paid on interest-bearing liabilities. Net interest income is affected by changes in the mix of the volume and rates of interest-earning assets and interest-bearing liabilities. The following table provides an analysis of net interest income, setting forth for the periods' (i) average assets, liabilities, and shareholders' equity, (ii) interest income earned on interest-earning assets and interest expense on interest-bearing liabilities, (iii) annualized average yields earned on interest-earning assets and average rates on interest-bearing liabilities, and (iv) Republic's annualized net interest margin (net interest income as a percentage of average total interest-earning assets). Averages are computed based on daily balances. Non-accrual loans are included in average loans receivable. All yields are adjusted for tax equivalency.



## Average Balances and Net Interest Income

| (dollars in thousands)                                     | For the three months ended<br>June 30, 2014 |          |                   | For the three months ended<br>June 30, 2013 |          |                   |  |  |
|------------------------------------------------------------|---------------------------------------------|----------|-------------------|---------------------------------------------|----------|-------------------|--|--|
|                                                            | Average<br>Balance                          | Interest | Yield/<br>Rate(1) | Average<br>Balance                          | Interest | Yield/<br>Rate(1) |  |  |
| Interest-earning assets:                                   |                                             |          |                   |                                             |          |                   |  |  |
| Federal funds sold and<br>other interest-earning<br>assets | \$ 82,915                                   | \$ 50    | 0.24 %            | \$ 62,419                                   | \$ 44    | 0.28 %            |  |  |
| Investment securities<br>and restricted stock              | 207,545                                     | 1,315    | 2.53 %            | 182,025                                     | 1,117    | 2.45 %            |  |  |
| Loans receivable                                           | 706,632                                     | 8,356    | 4.74 %            | 633,547                                     | 8,128    | 5.15 %            |  |  |
| Total interest-earning<br>assets                           | 997,092                                     | 9,721    | 3.91 %            | 877,991                                     | 9,289    | 4.24 %            |  |  |
| Other assets                                               | 48,652                                      |          |                   | 50,912                                      |          |                   |  |  |
| Total assets                                               | \$ 1,045,744                                |          |                   | \$ 928,903                                  |          |                   |  |  |
| Interest-earning<br>liabilities:                           |                                             |          |                   |                                             |          |                   |  |  |
| Demand – non-interest<br>bearing                           | \$ 177,363                                  |          |                   | \$ 141,390                                  |          |                   |  |  |
| Demand – interest<br>bearing                               | 232,682                                     | 225      | 0.39 %            | 180,824                                     | 207      | 0.46 %            |  |  |
| Money market &<br>savings                                  | 427,589                                     | 467      | 0.44 %            | 417,567                                     | 428      | 0.41 %            |  |  |
| Time deposits                                              | 78,259                                      | 178      | 0.91 %            | 88,994                                      | 204      | 0.92 %            |  |  |
| Total deposits                                             | 915,893                                     | 870      | 0.38 %            | 828,775                                     | 839      | 0.41 %            |  |  |
| Total interest-bearing<br>deposits                         | 738,530                                     | 870      | 0.47 %            | 687,385                                     | 839      | 0.49 %            |  |  |
| Other borrowings                                           | 22,476                                      | 277      | 4.94 %            | 22,476                                      | 278      | 4.96 %            |  |  |
| Total interest-bearing<br>liabilities                      | 761,006                                     | 1,147    | 0.60 %            | 709,861                                     | 1,117    | 0.63 %            |  |  |
| Total deposits and<br>other borrowings                     | 938,369                                     | 1,147    | 0.49 %            | 851,251                                     | 1,117    | 0.53 %            |  |  |
| Non interest-bearing<br>other liabilities                  | 6,741                                       |          |                   | 7,379                                       |          |                   |  |  |
| Shareholders' equity                                       | 100,634                                     |          |                   | 70,273                                      |          |                   |  |  |
| Total liabilities and<br>shareholders' equity              | \$ 1,045,744                                |          |                   | \$ 928,903                                  |          |                   |  |  |
| Net interest income (2)                                    |                                             | \$ 8,574 |                   |                                             | \$ 8,172 |                   |  |  |
| Net interest spread                                        |                                             |          | 3.31 %            |                                             |          | 3.61 %            |  |  |
| Net interest margin (2)                                    |                                             |          | 3.45 %            |                                             |          | 3.73 %            |  |  |

(1) Yields on investments are calculated based on amortized cost.

(2) Net interest income and net interest margin are presented on a tax equivalent basis. Net interest income has been increased over the financial statement amount by \$90 and \$74 for the three months ended June 30, 2014 and 2013, respectively, to adjust for tax equivalency. The tax equivalent net interest margin is calculated by dividing tax equivalent net interest income by average total interest earning assets.

## Average Balances and Net Interest Income

| (dollars in thousands)                               | For the six months ended<br>June 30, 2014 |           |                   | For the six months ended<br>June 30, 2013 |           |                   |
|------------------------------------------------------|-------------------------------------------|-----------|-------------------|-------------------------------------------|-----------|-------------------|
|                                                      | Average<br>Balance                        | Interest  | Yield/<br>Rate(1) | Average<br>Balance                        | Interest  | Yield/<br>Rate(1) |
| Interest-earning assets:                             |                                           |           |                   |                                           |           |                   |
| Federal funds sold and other interest-earning assets | \$ 50,552                                 | \$ 62     | 0.25 %            | \$ 74,485                                 | \$ 103    | 0.28 %            |
| Investment securities and restricted stock           | 207,793                                   | 2,678     | 2.58 %            | 182,702                                   | 2,276     | 2.49 %            |
| Loans receivable                                     | 696,805                                   | 16,723    | 4.84 %            | 627,628                                   | 16,105    | 5.17 %            |
| Total interest-earning assets                        | 955,150                                   | 19,463    | 4.11 %            | 884,815                                   | 18,484    | 4.21 %            |
| Other assets                                         | 45,818                                    |           |                   | 55,299                                    |           |                   |
| Total assets                                         | \$ 1,000,968                              |           |                   | \$ 940,114                                |           |                   |
| Interest-earning liabilities:                        |                                           |           |                   |                                           |           |                   |
| Demand – non-interest bearing                        | \$ 173,552                                |           |                   | \$ 142,710                                |           |                   |
| Demand – interest bearing                            | 223,383                                   | 416       | 0.38 %            | 175,873                                   | 402       | 0.46 %            |
| Money market & savings                               | 414,308                                   | 883       | 0.43 %            | 420,152                                   | 930       | 0.45 %            |
| Time deposits                                        | 77,865                                    | 351       | 0.91 %            | 101,455                                   | 483       | 0.96 %            |
| Total deposits                                       | 889,108                                   | 1,650     | 0.37 %            | 840,190                                   | 1,815     | 0.44 %            |
| Total interest-bearing deposits                      | 715,556                                   | 1,650     | 0.47 %            | 697,480                                   | 1,815     | 0.52 %            |
| Other borrowings                                     | 22,476                                    | 553       | 4.96 %            | 22,476                                    | 556       | 4.99 %            |
| Total interest-bearing liabilities                   | 738,032                                   | 2,203     | 0.60 %            | 719,956                                   | 2,371     | 0.66 %            |
| Total deposits and other borrowings                  | 911,584                                   | 2,203     | 0.49 %            | 862,666                                   | 2,371     | 0.55 %            |
| Non interest-bearing other liabilities               | 6,838                                     |           |                   | 7,424                                     |           |                   |
| Shareholders' equity                                 | 82,546                                    |           |                   | 70,024                                    |           |                   |
| Total liabilities and shareholders' equity           | \$ 1,000,968                              |           |                   | \$ 940,114                                |           |                   |
| Net interest income (2)                              |                                           | \$ 17,260 |                   |                                           | \$ 16,113 |                   |
| Net interest spread                                  |                                           |           | 3.51 %            |                                           |           | 3.55 %            |
| Net interest margin (2)                              |                                           |           | 3.64 %            |                                           |           | 3.67 %            |

(1) Yields on investments are calculated based on amortized cost.

(2) Net interest income and net interest margin are presented on a tax equivalent basis. Net interest income has been increased over the financial statement amount by \$177 and \$162 for the six months ended June 30, 2014 and 2013,

respectively, to adjust for tax equivalency. The tax equivalent net interest margin is calculated by dividing tax equivalent net interest income by average total interest earning assets.

## Rate/Volume Analysis of Changes in Net Interest Income

Net interest income may also be analyzed by segregating the volume and rate components of interest income and interest expense. The following table sets forth an analysis of volume and rate changes in net interest income for the three and six months ended June 30, 2014, as compared to the three and six months ended June 30, 2013. For purposes of this table, changes in interest income and expense are allocated to volume and rate categories based upon the respective changes in average balances and average rates.

| (dollars in thousands)                                      | For the three months ended<br>June 30, 2014 vs. 2013 |                  |                 | For the six months ended<br>June 30, 2014 vs. 2013 |                  |                 |
|-------------------------------------------------------------|------------------------------------------------------|------------------|-----------------|----------------------------------------------------|------------------|-----------------|
|                                                             | Changes due to:                                      |                  |                 | Changes due to:                                    |                  |                 |
|                                                             | Average<br>Volume                                    | Average<br>Rate  | Total<br>Change | Average<br>Volume                                  | Average<br>Rate  | Total<br>Change |
| <b>Interest earned:</b>                                     |                                                      |                  |                 |                                                    |                  |                 |
| <b>Federal funds sold and other interest-earning assets</b> |                                                      |                  |                 |                                                    |                  |                 |
|                                                             | \$ 15                                                | \$ (9 )          | \$ 6            | \$ (29 )                                           | \$ (12 )         | \$ (41 )        |
| Securities                                                  | 161                                                  | 37               | 198             | 323                                                | 79               | 402             |
| Loans                                                       | 844                                                  | (616 )           | 228             | 1,617                                              | (999 )           | 618             |
| <b>Total interest-earning assets</b>                        | <b>1,020</b>                                         | <b>(588 )</b>    | <b>432</b>      | <b>1,911</b>                                       | <b>(932 )</b>    | <b>979</b>      |
| <b>Interest expense:</b>                                    |                                                      |                  |                 |                                                    |                  |                 |
| <b>Deposits</b>                                             |                                                      |                  |                 |                                                    |                  |                 |
| <b>Interest-bearing demand deposits</b>                     |                                                      |                  |                 |                                                    |                  |                 |
|                                                             | 50                                                   | (32 )            | 18              | 88                                                 | (74 )            | 14              |
| <b>Money market and savings</b>                             | 11                                                   | 28               | 39              | (11 )                                              | (36 )            | (47 )           |
| <b>Time deposits</b>                                        | (25 )                                                | (1 )             | (26 )           | (106 )                                             | (26 )            | (132 )          |
| <b>Total deposit interest expense</b>                       | <b>36</b>                                            | <b>(5 )</b>      | <b>31</b>       | <b>(29 )</b>                                       | <b>(136 )</b>    | <b>(165 )</b>   |
| <b>Other borrowings</b>                                     | -                                                    | (1 )             | (1 )            | -                                                  | (3 )             | (3 )            |
| <b>Total interest expense</b>                               | <b>36</b>                                            | <b>(6 )</b>      | <b>30</b>       | <b>(29 )</b>                                       | <b>(139 )</b>    | <b>(168 )</b>   |
| <b>Net interest income</b>                                  | <b>\$ 984</b>                                        | <b>\$ (582 )</b> | <b>\$ 402</b>   | <b>\$ 1,940</b>                                    | <b>\$ (793 )</b> | <b>\$ 1,147</b> |

## Net Interest Income

The Company's total tax equivalent interest income increased \$432,000, or 4.7%, to \$9.7 million for the three months ended June 30, 2014 compared to \$9.3 million for the three months ended June 30, 2013. A \$73.1 million increase in average loans receivable and a \$25.5 million increase in average investment securities were partially offset by a 41 basis point decrease in loan yields for the three months ended June 30, 2014 as compared to June 30, 2013. For the six months ended June 30, 2014, total tax equivalent interest income increased \$979,000, or 5.3%, to \$19.5 million compared to the six months ended June 30, 2013. The increases in average loans receivable of \$69.2 million and average investment securities of \$25.1 million was offset by a 33 basis point decrease in loan yields for the six months ended June 30, 2014 as compared to June 30, 2013.

The Company's total interest expense remained flat at \$1.1 million for the three months ended June 30, 2014 when compared to the three months ended June 30, 2013. Total interest expense for the six months ended June 30, 2014 decreased \$168,000, or 7.1%, to \$2.2 million as compared to \$2.4 million for the six months ended June 30, 2013. Average deposit balances increased \$87.1 million and \$48.9 million for the three and six months ended June 30, 2014 respectively, as a result of the Company's retail focused, customer service strategy, which emphasizes the gathering of low-cost core deposits and has enabled the Company to reduce its dependence on wholesale funding sources like higher cost internet-based certificates of deposit. The average rate paid on interest-bearing deposits decreased 2 basis points to 0.47%, and 5 basis points to 0.47%, for the three and six months ended June 30, 2014, respectively, compared to 0.49% and 0.52% for the same prior year periods. Average time deposit balances declined \$10.7 million and \$23.6 million for the three and six months ended June 30, 2014, respectively, primarily as a result of the intentional effort to reduce balances of non-core, internet-based CDs. Accordingly, rates on total interest-bearing liabilities decreased 3 and 6 basis points during the three and six months ended June 30, 2014, respectively.

The tax equivalent net interest margin decreased 28 basis points to 3.45% for the three months ended June 30, 2014, compared to 3.73% for the three months ended June 30, 2013. The decrease in the net interest margin during the three months ended June 30, 2014 was driven by an adjustment to interest income related to a non-performing loan and an increase in federal funds sold and other interest-earning assets during the period which generated a lower yield than loans and investment securities. The Company's tax equivalent net interest income increased \$402,000, or 4.9%, to \$8.6 million for the three months ended June 30, 2014 as compared to \$8.2 million for the three months ended June 30, 2013. For the six months ended June 30, 2014, the tax equivalent net interest margin decreased 3 basis points to 3.64%, compared to 3.67% for the six months ended June 30, 2013 and the Company's tax equivalent net interest income increased \$1.1 million, or 7.1%, to \$17.3 million for the six months ended June 30, 2014 as compared \$16.1 million for the six months ended June 30, 2013.

#### Provision for Loan Losses

The Company recorded a \$300,000 provision for loan losses for the three and six months ended June 30, 2014 compared to a \$925,000 provision for the three and six months ended June 30, 2013. The provision for loan losses is charged to operations in an amount necessary to bring the total allowance for loan losses to a level that management believes is adequate to absorb inherent losses in the loan portfolio. The provision recorded for the three and six months ended June 30, 2014 as compared to the three and six months ended June 30, 2013 was driven by a reduction in the allowance for loan losses related to non-impaired loans evaluated collectively for impairment. The decrease associated with loans collectively evaluated for impairment was driven by a reduction in the factor used in the calculation related to historical charge-offs which has declined as a result of improved asset quality and lower charge-offs in recent years.

#### Non-Interest Income

Total non-interest income decreased \$581,000 to \$2.3 million for the three months ended June 30, 2014, compared to \$2.9 million for the three months ended June 30, 2013. For the six months ended June 30, 2014, total non-interest income decreased \$894,000 to \$4.2 million as compared to \$5.1 million for the six months ended June 30, 2013. The decreases were primarily due to a reduction in gains recognized on the sale of SBA loans for both the three and six months ended June 30, 2014 as compared to the three and six months ended June 30, 2013.

#### Non-Interest Expenses

Total non-interest expenses increased \$901,000 to \$10.0 million for the three months ended June 30, 2014 as compared to \$9.1 million for the three months ended June 30, 2013. For the six months ended June 30, 2014, total non-interest expenses increased \$1.6 million to \$19.8 million, compared to \$18.2 million for the six months ended June 30, 2013. For the six months ended June 30, 2014 as compared to the prior year period, salaries and benefits expense increased by \$1.1 million driven primarily by annual merit increases and higher occupancy expenses increased by \$459,000 related primarily to the Company's growth strategy of adding and relocating stores.

#### Benefit for Income Taxes

The Company recorded a benefit for income taxes of \$21,000 for the three months ended June 30, 2014, compared to a \$24,000 benefit for the three months ended June 30, 2013. For the six months ended June 30, 2014, the Company recorded a benefit of \$62,000 compared to a benefit of \$50,000 for the six months ended June 30, 2013. The \$62,000 benefit recorded during the first six months of 2014 was the net result of a tax provision in the amount of \$332,000 calculated on the net profit generated during the period using the Company's normal estimated tax rate, offset by an adjustment to the deferred tax asset valuation allowance in the amount of \$394,000. The effective tax rates for the three-month periods ended June 30, 2014 and 2013 were 25% and 29%, respectively, and for the six month periods

ended June 30, 2014 and 2013 were 27% and 29%, respectively, excluding an adjustment to the deferred tax asset valuation allowance.

The Company evaluates the carrying amount of its deferred tax assets on a quarterly basis or more frequently, if necessary, in accordance with the guidance provided in Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic 740 (ASC 740), in particular, applying the criteria set forth therein to determine whether it is more likely than not (i.e. a likelihood of more than 50%) that some portion, or all, of the deferred tax asset will not be realized within its life cycle, based on the weight of available evidence. If management makes a determination based on the available evidence that it is more likely than not that some portion or all of the deferred tax assets will not be realized in future periods, a valuation allowance is calculated and recorded. These determinations are inherently subjective and dependent upon estimates and judgments concerning management's evaluation of both positive and negative evidence.

In conducting the deferred tax asset analysis, the Company believes it is important to consider the unique characteristics of an industry or business. In particular, characteristics such as business model, level of capital and reserves held by financial institutions and their ability to absorb potential losses are important distinctions to be considered for bank holding companies like the Company. In addition, it is also important to consider that NOLs for federal income tax purposes can generally be carried back two years and carried forward for a period of twenty years. In order to realize our deferred tax assets, we must generate sufficient taxable income in such future years.

In assessing the need for a valuation allowance, the Company carefully weighed both positive and negative evidence currently available. Judgment is required when considering the relative impact of such evidence. The weight given to the potential effect of positive and negative evidence must be commensurate with the extent to which it can be objectively verified. A cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome. Based on the analysis of available positive and negative evidence, the Company determined that a valuation allowance should be recorded as of June 30, 2014 and December 31, 2013.

When calculating an estimate for a valuation allowance, the Company assessed the possible sources of taxable income available under tax law to realize a tax benefit for deductible temporary differences and carry forwards as defined in ASC 740. As a result of cumulative losses in recent years and the slow, ongoing recovery in the current economic environment, the Company did not use projections of future taxable income, exclusive of reversing temporary timing differences and carryforwards, as a factor. The Company will exclude future taxable income as a factor until it can show consistent and sustainable profitability.

The Company did assess tax planning strategies as defined under ASC 740 to determine the amount of a valuation allowance. Strategies reviewed included the sale of investment securities and loans with fair values greater than book values, redeployment of cash and cash equivalents into higher yielding investment options, a switch from tax-exempt to taxable investments and loans, and the election of a decelerated depreciation method for tax purposes on future fixed asset purchases. The Company believes that these tax planning strategies are (a) prudent and feasible, (b) steps that the Company would not ordinarily take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in the realization of existing deferred tax assets. These tax planning strategies, if implemented, would result in taxable income in the first full reporting period after deployment and accelerate the recovery of deferred tax asset balances if faced with the inability to recover those assets or the risk of potential expiration. The Company believes that these are viable tax planning strategies and appropriately considered in the analysis at this time, but may not align with the strategic direction of the organization today and therefore, has no present intention to implement such strategies.



The net deferred tax asset balance before consideration of a valuation allowance was \$20.0 million as of June 30, 2014 and \$21.4 million as of December 31, 2013. After assessment of all available tax planning strategies, the Company determined that a partial valuation allowance in the amount of \$14.9 million as of June 30, 2014 and \$15.3 million as of December 31, 2013 should be recorded.

The deferred tax asset will continue to be analyzed on a quarterly basis for changes affecting realizability. When the determination is made to include projections of future taxable income as a factor in recovering the deferred tax asset, the valuation allowance will be reduced accordingly resulting in a corresponding increase in net income.

#### Commitments, Contingencies and Concentrations

Financial instruments, whose contract amounts represent potential credit risk, were commitments to extend credit of approximately \$132.7 million and \$109.3 million, and standby letters of credit of approximately \$3.5 million and \$2.7 million, at June 30, 2014 and December 31, 2013, respectively. These financial instruments constitute off-balance sheet arrangements. Commitments often expire without being drawn upon. Substantially all of the \$132.7 million of commitments to extend credit at June 30, 2014 were committed as variable rate credit facilities.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the commitment. The Company's commitments generally have fixed expiration dates or other termination clauses and many require the payment of fees. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. In issuing commitments, the Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral required in connection with any commitment is based on management's credit evaluation of the customer. The type of required collateral varies, but may include real estate, marketable securities, pledged deposits, equipment and accounts receivable.

Standby letters of credit are conditional commitments that guarantee the performance of a customer to a third party. The credit risk and collateral policy involved in issuing letters of credit is essentially the same as that involved in issuing loan commitments. The amount of collateral which may be pledged to secure a letter of credit is based on management's credit evaluation of the customer. The type of collateral which may be held varies, but may include real estate, marketable securities, pledged deposits, equipment and accounts receivable.

## Regulatory Matters

The following table presents the capital regulatory ratios for both Republic and the Company as of June 30, 2014, and December 31, 2013 (dollars in thousands):

|                             | Actual    |       | For Capital Adequacy Purposes |          |        |       | To be well capitalized under regulatory capital guidelines |       |   |
|-----------------------------|-----------|-------|-------------------------------|----------|--------|-------|------------------------------------------------------------|-------|---|
|                             | Amount    | Ratio | Amount                        | Ratio    | Amount | Ratio | Amount                                                     | Ratio |   |
| At June 30, 2014:           |           |       |                               |          |        |       |                                                            |       |   |
| Total risk based capital    |           |       |                               |          |        |       |                                                            |       |   |
| Republic                    | \$120,471 | 13.92 | %                             | \$69,214 | 8.00   | %     | \$86,517                                                   | 10.00 | % |
| Company                     | 141,248   | 16.31 | %                             | 69,267   | 8.00   | %     | -                                                          | -     | % |
| Tier one risk based capital |           |       |                               |          |        |       |                                                            |       |   |
| Republic                    | 109,641   | 12.67 | %                             | 34,607   | 4.00   | %     | 51,910                                                     | 6.00  | % |
| Company                     | 130,410   | 15.06 | %                             | 34,633   | 4.00   | %     | -                                                          | -     | % |
| Tier one leveraged capital  |           |       |                               |          |        |       |                                                            |       |   |
| Republic                    | 109,641   | 10.53 | %                             | 41,637   | 4.00   | %     | 52,046                                                     | 5.00  | % |
| Company                     | 130,410   | 12.51 | %                             | 41,687   | 4.00   | %     | -                                                          | -     | % |
| At December 31, 2013:       |           |       |                               |          |        |       |                                                            |       |   |
| Total risk based capital    |           |       |                               |          |        |       |                                                            |       |   |
| Republic                    | \$92,493  | 11.38 | %                             | \$65,038 | 8.00   | %     | \$81,297                                                   | 10.00 | % |
| Company                     | 93,848    | 11.53 | %                             | 65,092   | 8.00   | %     | -                                                          | -     | % |
| Tier one leveraged capital  |           |       |                               |          |        |       |                                                            |       |   |
| Republic                    | 82,305    | 10.12 | %                             | 32,519   | 4.00   | %     | 48,778                                                     | 6.00  | % |
| Company                     | 83,652    | 10.28 | %                             | 32,546   | 4.00   | %     | -                                                          | -     | % |
| Tier one leveraged capital  |           |       |                               |          |        |       |                                                            |       |   |
| Republic                    | 82,305    | 8.46  | %                             | 38,921   | 4.00   | %     | 48,651                                                     | 5.00  | % |
| Company                     | 83,652    | 8.59  | %                             | 38,971   | 4.00   | %     | -                                                          | -     | % |

## Dividend Policy

The Company has not paid any cash dividends on its common stock. The Company has no plans to pay cash dividends in 2014. The Company's ability to pay dividends depends primarily on receipt of dividends from the Company's subsidiary, Republic. Dividend payments from Republic are subject to legal and regulatory limitations. The ability of Republic to pay dividends is also subject to profitability, financial condition, capital expenditures and other cash flow requirements.

## Liquidity

Financial institutions must maintain liquidity to meet day-to-day requirements of depositors and borrowers, time investment purchases to market conditions and provide a cushion against unforeseen needs. Liquidity needs can be met by either reducing assets or increasing liabilities. The most liquid assets consist of cash and amounts due from banks.

Regulatory authorities require the Company to maintain certain liquidity ratios in order for funds to be available to satisfy commitments to borrowers and the demands of depositors. In response to these requirements, the Company has formed an asset/liability committee (ALCO), comprised of certain members of Republic's board of directors and senior management to monitor such ratios. The ALCO committee is responsible for managing the liquidity position and interest sensitivity. That committee's primary objective is to maximize net interest income while configuring Republic's interest-sensitive assets and liabilities to manage interest rate risk and provide adequate liquidity for projected needs. The ALCO committee meets on a quarterly basis or more frequently if deemed necessary.

The Company's target and actual liquidity levels are determined by comparisons of the estimated repayment and marketability of interest-earning assets with projected future outflows of deposits and other liabilities. The Company's most liquid assets, comprised of cash and cash equivalents on the balance sheet, totaled \$83.1 million at June 30, 2014, compared to \$35.9 million at December 31, 2013. Loan maturities and repayments are another source of asset liquidity. At June 30, 2014, Republic estimated that more than \$45.0 million of loans would mature or repay in the six-month period ending December 31, 2014. Additionally, the majority of its investment securities are available to satisfy liquidity requirements if necessary. At June 30, 2014, the Company had outstanding commitments (including unused lines of credit and letters of credit) of \$136.2 million. Certificates of deposit scheduled to mature in one year totaled \$53.1 million at June 30, 2014. The Company anticipates that it will have sufficient funds available to meet its current commitments.

Daily funding requirements have historically been satisfied by generating core deposits and certificates of deposit with competitive rates, buying federal funds or utilizing the credit facilities of the Federal Home Loan Bank System ("FHLB"). The Company has established a line of credit with the FHLB of Pittsburgh with total borrowing capacity in the amount of \$383.1 million as of June 30, 2014. As of June 30, 2014 and December 31, 2013, the Company had no outstanding term borrowings with the FHLB. The Company had no short-term borrowings at both June 30, 2014 and December 31, 2013. The Company has also established a contingency line of credit of \$10.0 million with Atlantic Central Bankers Bank ("ACBB") to assist in managing its liquidity position. The Company had no amounts outstanding against the ACBB line of credit at both June 30, 2014 and December 31, 2013.

On April 22, 2014, the Company issued 11,842,106 shares of its common stock for an aggregate purchase price of \$45.0 million. The registration statement covering the resale of these shares by such investors was declared effective May 22, 2014 by the SEC.

#### Investment Securities Portfolio

At June 30, 2014, the Company identified certain investment securities that were being held for indefinite periods of time, including securities that will be used as part of the Company's asset/liability management strategy and that may be sold in response to changes in interest rates, prepayments and similar factors. These securities are classified as available for sale and are intended to increase the flexibility of the Company's asset/liability management. Available for sale securities consist primarily of U.S Government Agency mortgage-backed securities (MBS), agency collateralized mortgage obligations (CMO), municipal securities, corporate bonds, asset-backed securities and pooled trust preferred securities (CDO). Available-for-sale securities totaled \$219.6 million and \$204.9 million as of June 30, 2014 and December 31, 2013, respectively. At June 30, 2014 and December 31, 2013, the portfolio had net unrealized losses of \$1.2 million and \$4.4 million, respectively.

#### Loan Portfolio

The Company's loan portfolio consists of secured and unsecured commercial loans including commercial real estate, construction loans, residential mortgages, automobile loans, home improvement loans, home equity loans and lines of credit, overdraft lines of credit and others. Commercial loans are primarily secured term loans made to small to medium-sized businesses and professionals for working capital, asset acquisition and other purposes. Commercial loans are originated as either fixed or variable rate loans with typical terms of 1 to 5 years. Republic's commercial loans typically range between \$250,000 and \$5,000,000 million but customers may borrow significantly larger amounts up to Republic's combined legal lending limit, which was approximately \$18.2 million at June 30, 2014. Individual customers may have several loans often secured by different collateral.



## Credit Quality

Republic's written lending policies require specified underwriting, loan documentation and credit analysis standards to be met prior to funding, with independent credit department approval for the majority of new loan balances. A committee consisting of senior management and certain members of the Board of Directors oversees the loan approval process to monitor that proper standards are maintained, while approving the majority of commercial loans.

Loans, including impaired loans, are generally classified as non-accrual if they are past due as to maturity or payment of interest or principal for a period of more than 90 days, unless such loans are well-secured and in the process of collection. Loans that are on a current payment status or past due less than 90 days may also be classified as non-accrual if repayment in full of principal and/or interest is in doubt.

Loans may be returned to accrual status when all principal and interest amounts contractually due are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower, in accordance with the contractual terms.

While a loan is classified as non-accrual or as an impaired loan and the future collectability of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding. When the future collectability of the recorded loan balance is expected, interest income may be recognized on a cash basis. For non-accrual loans, which have been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

The following table shows information concerning loan delinquency and non-performing assets as of the dates indicated (dollars in thousands):

|                                                                             | June 30,<br>2014 | December<br>31, 2013 |      |   |
|-----------------------------------------------------------------------------|------------------|----------------------|------|---|
| Loans accruing, but past due 90 days or more                                | \$2,722          | \$-                  |      |   |
| Non-accrual loans                                                           | 24,196           | 10,420               |      |   |
| Total non-performing loans                                                  | 26,918           | 10,420               |      |   |
| Other real estate owned                                                     | 3,637            | 4,059                |      |   |
| Total non-performing assets                                                 | \$30,555         | \$14,479             |      |   |
| Non-performing loans as a percentage of total loans, net of unearned income | 3.74             | %                    | 1.53 | % |
| Non-performing assets as a percentage of total assets                       | 2.87             | %                    | 1.51 | % |

Non-performing assets increased by \$16.1 million to \$30.6 million as of June 30, 2014, from \$14.5 million at December 31, 2013. Non-accrual loans increased by \$13.8 million to \$24.2 million as of June 30, 2014, from \$10.4 million at December 31, 2013. These increases were primarily driven by one loan in the amount of \$13.0 million that became more than ninety days delinquent and was transferred to non-accrual status in the current quarter. A reserve for this loan was recorded during the fourth quarter of 2013 when it was initially downgraded to impaired status. Loans accruing, but past due 90 days or more were \$2.7 million as of June 30, 2014, compared to \$0 at December 31, 2013 which was driven by four loans which had reached maturity and were being extended or were in the process of collection as of June 30, 2014. In addition to non-accrual loans, impaired loans also include loans that are currently performing but potential credit concerns with the borrowers' financial condition have caused management to have doubts as to the ability of such borrowers to continue to comply with present repayment terms. At June 30, 2014 and

December 31, 2013, all identified impaired loans are internally classified and individually evaluated for impairment in accordance with the guidance under ASC 310.

Republic had delinquent loans as follows: (i) 30 to 59 days past due, in the aggregate principal amount of \$184,000 and \$21.5 million at June 30, 2014 and December 31, 2013, respectively; and (ii) 60 to 89 days past due, at June 30, 2014 and December 31, 2013, in the aggregate principal amount of \$14.3 million and \$7.0 million, respectively. Delinquent loans are currently in the process of collection and management believes they are supported by adequate collateral.

#### Other Real Estate Owned

The balance of other real estate owned decreased by \$422,000 to \$3.6 million at June 30, 2014 from \$4.1 million at December 31, 2013 primarily due to writedowns on one foreclosed property during the first six months of 2014.

The following table presents a reconciliation of other real estate owned for the six months ended June 30, 2014 and the year ended December 31, 2013:

| (dollars in thousands)         | June 30,<br>2014 | December 31,<br>2013 |
|--------------------------------|------------------|----------------------|
| Beginning Balance, January 1st | \$ 4,059         | \$ 8,912             |
| Additions                      | 193              | 246                  |
| Valuation adjustments          | (552 )           | (2,740 )             |
| Dispositions                   | (63 )            | (2,359 )             |
| Ending Balance                 | \$ 3,637         | \$ 4,059             |

At June 30, 2014, the Company had no credit exposure to “highly leveraged transactions” as defined by the FDIC.

#### Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable losses inherent in the loan portfolio. The Company evaluates the need to establish an allowance against loan losses on a quarterly basis. When an increase in this allowance is necessary, a provision for loan losses is charged to earnings. The allowance for loan losses consists of three components. The first component is allocated to individually evaluated loans found to be impaired and is calculated in accordance with ASC 310. The second component is allocated to all other loans that are not individually identified as impaired pursuant to ASC 310 (“non-impaired loans”). This component is calculated for all non-impaired loans on a collective basis in accordance with ASC 450. The third component is an unallocated allowance to account for a level of imprecision in management’s estimation process.

The Company evaluates loans for impairment and potential charge-off on a quarterly basis. Management regularly monitors the condition of borrowers and assesses both internal and external factors in determining whether any loan relationships have deteriorated. Any loan rated as substandard or lower will have an individual collateral evaluation analysis prepared to determine if a deficiency exists. We first evaluate the primary repayment source. If the primary repayment source is seriously inadequate and unlikely to repay the debt, we then look to the other available repayment sources. Secondary sources are conservatively reviewed for liquidation values. Updated appraisals and financial data are obtained to substantiate current values. If the reviewed sources are deemed to be inadequate to cover the outstanding principal and any costs associated with the resolution of the troubled loan, an estimate of the deficient amount will be calculated and a specific allocation of loan loss reserve is recorded.



Factors considered in the calculation of the allowance for non-impaired loans include several qualitative and quantitative factors such as historical loss experience, trends in delinquency and nonperforming loan balances, changes in risk composition and underwriting standards, experience and ability of management, and general economic conditions along with other external factors. Historical loss experience is analyzed by reviewing charge-offs over a three year period to determine loss rates consistent with the loan categories depicted in the allowance for loan loss table below.

The factors supporting the allowance for loan losses do not diminish the fact that the entire allowance for loan losses is available to absorb losses in the loan portfolio and related commitment portfolio, respectively. The Company's principal focus, therefore, is on the adequacy of the total allowance for loan losses. The allowance for loan losses is subject to review by banking regulators. The Company's primary bank regulators regularly conduct examinations of the allowance for loan losses and make assessments regarding the adequacy and the methodology employed in their determination.

An analysis of the allowance for loan losses for the six months ended June 30, 2014 and 2013, and the twelve months ended December 31, 2013 is as follows:

| (dollars in thousands)                 | For the six months<br>ended June 30, 2014 | For the twelve months<br>ended December 31,<br>2013 | For the six months<br>ended June 30, 2013 |   |      |
|----------------------------------------|-------------------------------------------|-----------------------------------------------------|-------------------------------------------|---|------|
| Balance at beginning of period         | \$ 12,263                                 | \$ 9,542                                            | \$ 9,542                                  |   |      |
| Charge offs:                           |                                           |                                                     |                                           |   |      |
| Commercial real estate                 | 188                                       | 1,291                                               | 409                                       |   |      |
| Construction and land development      | 20                                        | 60                                                  | 55                                        |   |      |
| Commercial and industrial              | 283                                       | 611                                                 | 361                                       |   |      |
| Owner occupied real estate             | -                                         | 320                                                 | 319                                       |   |      |
| Consumer and other                     | 10                                        | 75                                                  | 75                                        |   |      |
| Residential mortgage                   | -                                         | -                                                   | -                                         |   |      |
| Total charge offs                      | 501                                       | 2,357                                               | 1,219                                     |   |      |
| Recoveries:                            |                                           |                                                     |                                           |   |      |
| Commercial real estate                 | -                                         | 54                                                  | 54                                        |   |      |
| Construction and land development      | -                                         | -                                                   | -                                         |   |      |
| Commercial and industrial              | 1                                         | 63                                                  | 5                                         |   |      |
| Owner occupied real estate             | -                                         | -                                                   | -                                         |   |      |
| Consumer and other                     | -                                         | 26                                                  | 25                                        |   |      |
| Residential mortgage                   | -                                         | -                                                   | -                                         |   |      |
| Total recoveries                       | 1                                         | 143                                                 | 84                                        |   |      |
| Net charge offs                        | 500                                       | 2,214                                               | 1,135                                     |   |      |
| Provision for loan losses              | 300                                       | 4,935                                               | 925                                       |   |      |
| Balance at end of period               | \$ 12,063                                 | \$ 12,263                                           | \$ 9,332                                  |   |      |
| Average loans outstanding(1)           | \$ 696,805                                | \$ 640,233                                          | \$ 627,628                                |   |      |
| As a percent of average loans:(1)      |                                           |                                                     |                                           |   |      |
| Net charge offs (annualized)           | 0.14                                      | %                                                   | 0.35                                      | % | 0.36 |
| Provision for loan losses (annualized) | 0.09                                      | %                                                   | 0.77                                      | % | 0.29 |
| Allowance for loan losses              | 1.73                                      | %                                                   | 1.92                                      | % | 1.49 |
| Allowance for loan losses to:          |                                           |                                                     |                                           |   |      |

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|                                     |       |   |        |   |       |   |
|-------------------------------------|-------|---|--------|---|-------|---|
| Total loans, net of unearned income | 1.68  | % | 1.81   | % | 1.46  | % |
| Total non performing loans          | 44.81 | % | 117.69 | % | 69.96 | % |

(1) Includes non-accruing loans.

The Company recorded a \$300,000 provision for loan losses for the three and six months ended June 30, 2014 compared to a \$925,000 provision for the three and six months ended June 30, 2013. The provision for loan losses is charged to operations in an amount necessary to bring the total allowance for loan losses to a level that management believes is adequate to absorb inherent losses in the loan portfolio. The provision recorded for the three and six months ended June 30, 2014 as compared to the three and six months ended June 30, 2013 was driven by a reduction in the allowance for loan losses related to non-impaired loans evaluated collectively for impairment. The decrease associated with loans collectively evaluated for impairment was driven by a reduction in the factor used in the calculation related to historical charge-offs which has declined as a result of lower charge-offs in recent years.

The allowance for loan losses as a percentage of non-performing loans (coverage ratio) was 44.81% at June 30, 2014, compared to 117.69% at December 31, 2013 and 69.96% at June 30, 2013. Total non-performing loans were \$26.9 million, \$10.4 million and \$13.3 million at June 30, 2014, December 31, 2013 and June 30, 2013, respectively. The increase in non-performing loans was primarily driven by one loan that was transferred to non-performing status during the current period. A reserve for this loan was recorded during the fourth quarter of 2013 when it was initially downgraded to impaired status. The increase in non-performing loans has caused a corresponding decrease in the coverage ratio at June 30, 2014.

Our credit monitoring process assesses the ultimate collectability of an outstanding loan balance from all potential sources. When a loan is determined to be uncollectible it is charged-off against the allowance for loan losses. Unsecured commercial loans and all consumer loans are charged-off immediately upon reaching the 90-day delinquency mark unless they are well secured and in the process of collection. The timing on charge-offs of all other loan types is subjective and will be recognized when management determines that full repayment, either from the cash flow of the borrower, collateral sources, and/or guarantors, will not be sufficient and that repayment is unlikely. A full or partial charge-off is recognized equal to the amount of the estimated deficiency calculation.

Serious delinquency is often the first indicator of a potential charge-off. Reductions in appraised collateral values and deteriorating financial condition of borrowers and guarantors are factors considered when evaluating potential charge-offs. The likelihood of possible recoveries or improvements in a borrower's financial condition are also assessed when considering a charge-off. The Company recorded net charge-offs of \$500,000 during the six month period ended June 30, 2014, compared to \$1.1 million during the six month period ended June 30, 2013.

Partial charge-offs of non-performing and impaired loans can significantly reduce the coverage ratio and other credit loss statistics due to the fact that the balance of the allowance for loan losses will be reduced while still carrying the remainder of a non-performing loan balance in the impaired loan category. The amount of non-performing loans for which partial charge-offs have been recorded amounted to \$18.8 million at June 30, 2014 compared to \$6.2 million at December 31, 2013.

The following table provides additional analysis of partially charged-off loans.

| (dollars in thousands)                                                             | June 30,<br>2014 | December<br>31, 2013 |        |   |
|------------------------------------------------------------------------------------|------------------|----------------------|--------|---|
| Total nonperforming loans                                                          | \$26,918         | \$10,420             |        |   |
| Nonperforming and impaired loans with partial charge-offs                          | 18,800           | 6,236                |        |   |
| Ratio of nonperforming loans with partial charge-offs to total loans               | 2.61             | %                    | 0.92   | % |
| Ratio of nonperforming loans with partial charge-offs to total nonperforming loans | 69.84            | %                    | 59.85  | % |
| Coverage ratio net of nonperforming loans with partial charge-offs                 | 64.16            | %                    | 196.65 | % |

The Company's charge-off policy is reviewed on an annual basis and updated as necessary. During the six month period ended June 30, 2014, there were no changes made to this policy.

## Recent Accounting Pronouncements

### ASU 2014-04

In January 2014, the FASB issued ASU 2014-04, “Receivables – Troubled Debt Restructuring by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure – a consensus of the FASB Emerging Issues Task Force.” The guidance clarifies when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate property recognized. For public business entities, the ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For entities other than public business entities, the ASU is effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. The Company does not believe the adoption of the amendment to this guidance will have a material impact on the consolidated financial statements.

### ASU 2014-09

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 660): Summary and Amendments that Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs – Contracts with Customers (Subtopic 340-40).” The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the codification. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2016. The Company is currently assessing the impact that this guidance will have on its consolidated financial statements, but does not expect the guidance to have a material impact on the Company’s consolidated financial statements.

## Effects of Inflation

The majority of assets and liabilities of a financial institution are monetary in nature. Therefore, a financial institution differs greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. Management believes that the most significant impact of inflation on its financial results is through the Company’s need and ability to react to changes in interest rates. Management attempts to maintain an essentially balanced position between rate sensitive assets and liabilities over a one-year time horizon in order to protect net interest income from being affected by wide interest rate fluctuations.

## ITEM 3: QUANTITATIVE AND QUALITATIVE INFORMATION ABOUT MARKET RISK

There has been no material change in the Company’s assessment of its sensitivity to market risk since its presentation in the Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed with the SEC on March 24, 2014.

## ITEM 4: CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and

reported within the time periods specified in the Securities and Exchange Commission's rules and forms and accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

The Company's management, with the participation of the principal executive officer and the principal financial officer, conducted an evaluation, as of the end of the period covered by this report, of the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Exchange Act Rule 13a-15(e). Based on this evaluation, the principal executive officer and the principal financial officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures, as defined in Rule 13a-15(e), were effective at the reasonable assurance level.

#### Changes in Internal Controls

The principal executive officer and principal financial officer also conducted an evaluation of the Company's internal control over financial reporting ("Internal Control") to determine whether any changes in Internal Control occurred during the quarter ended June 30, 2014 that have materially affected or which are reasonably likely to materially affect Internal Control. Based on that evaluation, there has been no such change during the quarter ended June 30, 2014.

#### Limitations on the Effectiveness of Controls

Control systems, no matter how well designed and operated, can provide only reasonable, not an absolute, level of assurance that the objectives of the control system are met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of the effectiveness of controls to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The Company and Republic are from time to time parties (plaintiff or defendant) to lawsuits in the normal course of business. While any litigation involves an element of uncertainty, management is of the opinion that the liability of the Company and Republic, if any, resulting from such actions will not have a material effect on the financial condition or results of operations of the Company and Republic.

### ITEM 1A. RISK FACTORS

Significant risk factors could adversely affect the Company's business, financial condition and results of operation. Risk factors discussing these risks can be found in Part I, "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 and Form 10-Q for the quarter ended March 31, 2014. The risk factors in the Company's Annual Report on Form 10-K have not materially changed. You should carefully consider these risk factors. The risks described in the Company's Form 10-K and Form 10-Q are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.



ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

## ITEM 6. EXHIBITS

The following Exhibits are filed as part of this report. (Exhibit numbers correspond to the exhibits required by Item 601 of Regulation S-K for quarterly reports on Form 10-Q).

| Exhibit Number | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | Location                                                                |
|----------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------|
| 3.1            | Amended and Restated Articles of Incorporation of Republic First Bancorp, Inc.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Incorporated by reference to Form 8-K filed May 13, 2010                |
| 3.2            | Amended and Restated By-Laws of Republic First Bancorp, Inc.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | Incorporated by reference to Form S-1 filed April 23, 2010 (333-166286) |
| 10.1           | Form of Investment Agreement                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | Incorporated by reference to Form 8-K filed April 22, 2014              |
| 31.1           | <u>Rule 13a-14(a)/15d-14(a) Certification of Chairman and Chief Executive Officer of Republic First Bancorp, Inc.</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Filed herewith                                                          |
| 31.2           | <u>Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of Republic First Bancorp, Inc.</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | Filed herewith                                                          |
| 32.1           | <u>Section 1350 Certification of Harry D. Madonna</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Furnished herewith                                                      |
| 32.2           | <u>Section 1350 Certification of Frank A. Cavallaro</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | Furnished herewith                                                      |
| 101            | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013, (ii) Consolidated Statements of Income for the three and six months ended June 30, 2014 and 2013, (iii) Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2014 and 2013, (iv) Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2013, (v) Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2014 and 2013, and (vi) Notes to Consolidated Financial Statements. |                                                                         |



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

REPUBLIC FIRST BANCORP, INC.

Date: August 6, 2014

By: /s/ Harry D. Madonna  
Harry D. Madonna  
Chairman, President and Chief Executive Officer  
(principal executive officer)

Date: August 6, 2014

By: /s/ Frank A. Cavallaro  
Frank A. Cavallaro  
Executive Vice President and Chief Financial  
Officer  
(principal financial and accounting officer)