

SOUTHERN FIRST BANCSHARES INC  
Form 10-Q  
August 04, 2015

**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, 2015

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 000-27719

**Southern First Bancshares, Inc.**

(Exact name of registrant as specified in its charter)

**South Carolina**

(State or other jurisdiction of incorporation or organization)

**58-2459561**

(I.R.S. Employer Identification No.)

**100 Verdae Boulevard, Suite 100**

**Greenville, S.C.**

(Address of principal executive offices)

**29606**

(Zip Code)

**864-679-9000**

(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 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 (§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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Accelerated filer

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:  
6,236,144 shares of common stock, par value \$0.01 per share, were issued and outstanding as of July 28, 2015.

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**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY**  
**June 30, 2015 Form 10-Q**

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**PART I. CONSOLIDATED FINANCIAL INFORMATION**  
**Item 1. CONSOLIDATED FINANCIAL STATEMENTS**

**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**

| (dollars in thousands, except share data)   | June 30,<br>2015<br>(Unaudited) | December 31,<br>2014<br>(Audited) |
|---|---------------------------------|-----------------------------------|
| <b>ASSETS</b>   |                                 |                                   |
| Cash and cash equivalents:  |                                 |                                   |
| Cash and due from banks   | \$ 12,085                       | 9,862                             |
| Interest-bearing deposits with banks  | 5,219                           | 25,849                            |
| Federal funds sold  | 24,106                          | 5,553                             |
| Total cash and cash equivalents   | 41,410                          | 41,264                            |
| Investment securities:  |                                 |                                   |
| Investment securities available for sale  | 51,465                          | 55,024                            |
| Other investments   | 5,532                           | 6,522                             |
| Total investment securities   | 56,997                          | 61,546                            |
| Loans held for sale   | 12,402                          | 11,765                            |
| Loans   | 963,496                         | 871,446                           |
| Less allowance for loan losses  | (12,927)                        | (11,752)                          |
| Loans, net  | 950,569                         | 859,694                           |
| Bank owned life insurance   | 22,382                          | 22,050                            |
| Property and equipment, net   | 22,704                          | 20,845                            |
| Deferred income taxes   | 5,929                           | 5,509                             |
| Other assets  | 6,607                           | 7,192                             |
| Total assets  | \$ 1,119,000                    | 1,029,865                         |
| <b>LIABILITIES</b>  |                                 |                                   |
| Deposits  | \$ 894,524                      | 788,907                           |
| Federal Home Loan Bank advances and other borrowings  | 115,200                         | 135,200                           |
| Junior subordinated debentures  | 13,403                          | 13,403                            |
| Other liabilities   | 8,206                           | 9,363                             |
| Total liabilities   | 1,031,333                       | 946,873                           |
| <b>SHAREHOLDERS' EQUITY</b>   |                                 |                                   |
| Preferred stock, par value \$.01 per share, 10,000,000 shares authorized, no shares issued and outstanding  | -                               | -                                 |
| Common stock, par value \$.01 per share, 10,000,000 shares authorized, 6,236,144 and 6,219,002 shares issued and outstanding at June 30, 2015 and December 31, 2014, respectively | 62                              | 62                                |
| Nonvested restricted stock  | (400)                           | (494)                             |
| Additional paid-in capital  | 69,192                          | 68,785                            |
| Accumulated other comprehensive income (loss)   | (112)                           | 302                               |
| Retained earnings   | 18,925                          | 14,337                            |
| Total shareholders' equity  | 87,667                          | 82,992                            |
| Total liabilities and shareholders' equity  | \$ 1,119,000                    | 1,029,865                         |

See notes to consolidated financial statements that are an integral part of these consolidated statements.

**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

|   | For the three months<br>ended June 30, |           | For the six months<br>ended June 30, |           |
|---|--|-----------|--------------------------------------|-----------|
|   | 2015                                   | 2014      | 2015                                 | 2014      |
| (dollars in thousands, except share data)           |  |           |                                      |           |
| <b>Interest income</b>                              |  |           |                                      |           |
| Loans   | \$ 10,941                              | 9,309     | 21,341                               | 18,127    |
| Investment securities                               | 356                                    | 465       | 731                                  | 977       |
| Federal funds sold                                  | 19                                     | 16        | 45                                   | 30        |
| Total interest income                               | 11,316                                 | 9,790     | 22,117                               | 19,134    |
| <b>Interest expense</b>                             |  |           |                                      |           |
| Deposits  | 854                                    | 696       | 1,621                                | 1,376     |
| Borrowings  | 971                                    | 1,024     | 1,935                                | 2,044     |
| Total interest expense                              | 1,825                                  | 1,720     | 3,556                                | 3,420     |
| Net interest income                                 | 9,491                                  | 8,070     | 18,561                               | 15,714    |
| Provision for loan losses                           | 1,000                                  | 950       | 1,625                                | 1,950     |
| Net interest income after provision for loan losses | 8,491                                  | 7,120     | 16,936                               | 13,764    |
| <b>Noninterest income</b>                           |  |           |                                      |           |
| Loan and mortgage fee income                        | 1,409                                  | 613       | 2,605                                | 955       |
| Service fees on deposit accounts                    | 219                                    | 231       | 445                                  | 445       |
| Income from bank owned life insurance               | 165                                    | 167       | 331                                  | 329       |
| Gain on sale of investment securities               | 36                                     | 230       | 295                                  | 230       |
| Other income  | 286                                    | 277       | 580                                  | 529       |
| Total noninterest income                            | 2,115                                  | 1,518     | 4,256                                | 2,488     |
| <b>Noninterest expenses</b>                         |  |           |                                      |           |
| Compensation and benefits                           | 4,106                                  | 3,514     | 8,382                                | 6,925     |
| Occupancy   | 842                                    | 730       | 1,579                                | 1,457     |
| Real estate owned expenses                          | 93                                     | 12        | 855                                  | 25        |
| Data processing and related costs                   | 573                                    | 622       | 1,158                                | 1,216     |
| Insurance   | 213                                    | 203       | 415                                  | 395       |
| Professional fees                                   | 233                                    | 294       | 466                                  | 517       |
| Marketing   | 222                                    | 197       | 460                                  | 398       |
| Other   | 364                                    | 743       | 791                                  | 1,152     |
| Total noninterest expenses                          | 6,646                                  | 6,315     | 14,106                               | 12,085    |
| Income before income tax expense                    | 3,960                                  | 2,323     | 7,086                                | 4,167     |
| <b>Income tax expense</b>                           | 1,400                                  | 757       | 2,498                                | 1,351     |
| <b>Net income</b>                                   | 2,560                                  | 1,566     | 4,588                                | 2,816     |
| Preferred stock dividend                            | -                                      | 253       | -                                    | 445       |
| <b>Net income available to common shareholders</b>  | \$ 2,560                               | 1,313     | 4,588                                | 2,371     |
| <b>Earnings per common share</b>                    |  |           |                                      |           |
| Basic   | \$ 0.41                                | 0.28      | 0.74                                 | 0.51      |
| Diluted   | 0.39                                   | 0.26      | 0.70                                 | 0.48      |
| <b>Weighted average common shares outstanding</b>   |  |           |                                      |           |
| Basic   | 6,233,745                              | 4,763,407 | 6,229,522                            | 4,686,748 |
| Diluted   | 6,533,658                              | 5,036,553 | 6,524,317                            | 4,957,000 |

See notes to consolidated financial statements that are an integral part of these consolidated statements.

**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

| (dollars in thousands)   | For the three months<br>ended June 30, |       | For the six months<br>ended June 30, |       |
|--|--|-------|--------------------------------------|-------|
|  | 2015                                   | 2014  | 2015                                 | 2014  |
| Net income   | \$2,560                                | 1,566 | 4,588                                | 2,816 |
| Other comprehensive income (loss):                               |  |       |                                      |       |
| Unrealized gain (loss) on securities available for sale:         |  |       |                                      |       |
| Unrealized holding gain (loss) arising during the period, pretax | (689)                                  | 1,093 | (332)                                | 2,259 |
| Tax (expense) benefit  | 234                                    | (371) | 113                                  | (768) |
| Reclassification of realized gain                                | (36)                                   | (230) | (295)                                | (230) |
| Tax expense  | 12                                     | 78    | 100                                  | 78    |
| Other comprehensive income (loss)                                | (479)                                  | 570   | (414)                                | 1,339 |
| Comprehensive income   | \$2,081                                | 2,136 | 4,174                                | 4,155 |

See notes to consolidated financial statements that are an integral part of these consolidated statements.

**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2015 AND 2014**  
**(Unaudited)**

|   | Common stock     |              | Preferred stock |                  | Nonvested restricted stock | Additional paid-in capital | Accumulated other comprehensive income | Retained earnings | Total            |
|---|------------------|--------------|-----------------|------------------|----------------------------|----------------------------|--|-------------------|------------------|
|   | Shares           | Amount       | Shares          | Amount           | stock                      | capital                    | (loss)                                 | earnings          |                  |
| (dollars in thousands, except share data)                 |                  |              |                 |                  |                            |                            |  |                   |                  |
| <b>December 31, 2013</b>                                  | <b>4,319,750</b> | <b>\$ 43</b> | <b>15,299</b>   | <b>\$ 15,299</b> | <b>\$ (636)</b>            | <b>\$ 43,585</b>           | <b>\$ (1,348)</b>                      | <b>\$ 8,722</b>   | <b>\$ 65,665</b> |
| Net income  | -                | -            | -               | -                | -                          | -                          | -                                      | 2,816             | 2,816            |
| Preferred stock transactions:                             |                  |              |                 |                  |                            |                            |  |                   |                  |
| Redemption of preferred stock                             | -                | -            | (4,057)         | (4,057)          | -                          | -                          | -                                      | -                 | (4,057)          |
| Cash dividends on Series T preferred stock                | -                | -            | -               | -                | -                          | -                          | -                                      | (434)             | (434)            |
| Issuance of common stock                                  | 475,000          | 5            | -               | -                | -                          | 5,945                      | -                                      | -                 | 5,950            |
| Proceeds from exercise of stock options                   | 32,764           | -            | -               | -                | -                          | 287                        | -                                      | -                 | 287              |
| Issuance of restricted stock                              | 2,000            | -            | -               | -                | (27)                       | 27                         | -                                      | -                 | -                |
| Amortization of deferred compensation on restricted stock | -                | -            | -               | -                | 98                         | -                          | -                                      | -                 | 98               |
| Compensation expense related to stock options, net of tax | -                | -            | -               | -                | -                          | 222                        | -                                      | -                 | 222              |
| Other comprehensive income                                | -                | -            | -               | -                | -                          | -                          | 1,339                                  | -                 | 1,339            |
| <b>June 30, 2014</b>                                      | <b>4,829,514</b> | <b>48</b>    | <b>11,242</b>   | <b>11,242</b>    | <b>(565)</b>               | <b>50,066</b>              | <b>(9)</b>                             | <b>11,104</b>     | <b>71,886</b>    |
| <b>December 31, 2014</b>                                  | <b>6,219,002</b> | <b>62</b>    | <b>-</b>        | <b>-</b>         | <b>(494)</b>               | <b>68,785</b>              | <b>302</b>                             | <b>14,337</b>     | <b>82,992</b>    |
| Net income  | -                | -            | -               | -                | -                          | -                          | -                                      | 4,588             | 4,588            |
| Proceeds from exercise of stock options                   | 17,142           | -            | -               | -                | -                          | 117                        | -                                      | -                 | 117              |
| Amortization of deferred compensation on restricted stock | -                | -            | -               | -                | 94                         | -                          | -                                      | -                 | 94               |
| Compensation expense related to stock options, net of tax | -                | -            | -               | -                | -                          | 290                        | -                                      | -                 | 290              |
| Other comprehensive loss                                  | -                | -            | -               | -                | -                          | -                          | (414)                                  | -                 | (414)            |
| <b>June 30, 2015</b>                                      | <b>6,236,144</b> | <b>\$ 62</b> | <b>-</b>        | <b>\$ -</b>      | <b>\$ (400)</b>            | <b>\$ 69,192</b>           | <b>\$ (112)</b>                        | <b>\$ 18,925</b>  | <b>\$ 87,667</b> |

See notes to consolidated financial statements that are an integral part of these consolidated statements.

**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

| (dollars in thousands)  | For the six months ended June 30, |               |
|---|-----------------------------------|---------------|
|   | 2015                              | 2014          |
| <b>Operating activities</b>   |                                   |               |
| Net income  | \$ 4,588                          | 2,816         |
| Adjustments to reconcile net income to cash provided by operating activities: |                                   |               |
| Provision for loan losses   | 1,625                             | 1,950         |
| Depreciation and other amortization   | 688                               | 591           |
| Accretion and amortization of securities discounts and premium, net           | 148                               | 200           |
| Gain on sale of investment securities available for sale                      | (295)                             | (230)         |
| Gain on sale of real estate owned   | (74)                              | -             |
| Write-down of real estate owned   | 737                               | -             |
| Compensation expense related to stock options and grants                      | 384                               | 320           |
| Gain on sale of loans held for sale   | (2,484)                           | (880)         |
| Loans originated and held for sale  | (106,754)                         | (37,555)      |
| Proceeds from sale of loans held for sale                                     | 108,601                           | 34,857        |
| Increase in cash surrender value of bank owned life insurance                 | (332)                             | (329)         |
| Increase in deferred tax asset  | (207)                             | (856)         |
| Decrease in other assets, net   | 165                               | 90            |
| Decrease in other liabilities   | (1,157)                           | (13)          |
| Net cash provided by operating activities                                     | 5,633                             | 961           |
| <b>Investing activities</b>   |                                   |               |
| Increase (decrease) in cash realized from:                                    |                                   |               |
| Origination of loans, net   | (92,843)                          | (80,392)      |
| Purchase of property and equipment  | (2,547)                           | (1,456)       |
| Purchase of investment securities:  |                                   |               |
| Available for sale  | (9,352)                           | (2,073)       |
| Other   | (149)                             | -             |
| Payments and maturity of investment securities:                               |                                   |               |
| Available for sale  | 2,359                             | 2,427         |
| Other   | 1,140                             | 157           |
| Proceeds from sale of investment securities available for sale                | 10,071                            | 10,427        |
| Proceeds from sale of real estate owned                                       | 100                               | 75            |
| Net cash used for investing activities  | (91,221)                          | (70,835)      |
| <b>Financing activities</b>   |                                   |               |
| Increase (decrease) in cash realized from:                                    |                                   |               |
| Increase in deposits, net   | 105,617                           | 67,050        |
| Increase in other borrowings  | -                                 | 3,000         |
| Decrease in Federal Home Loan Bank advances and other borrowings              | (20,000)                          | -             |
| Cash dividend on preferred stock  | -                                 | (434)         |
| Redemption of preferred stock   | -                                 | (4,057)       |
| Issuance of common stock  | -                                 | 5,950         |
| Proceeds from the exercise of stock options and warrants                      | 117                               | 287           |
| Net cash provided by financing activities                                     | 85,734                            | 71,796        |
| Net increase in cash and cash equivalents                                     | 146                               | 1,922         |
| <b>Cash and cash equivalents at beginning of the period</b>                   | <b>41,264</b>                     | <b>39,203</b> |
| <b>Cash and cash equivalents at end of the period</b>                         | <b>\$ 41,410</b>                  | <b>41,125</b> |
| <b>Supplemental information</b>   |                                   |               |
| <b>Cash paid for</b>  |                                   |               |
| Interest  | \$ 3,634                          | 3,320         |
| Income taxes  | 2,705                             | 2,207         |
| <b>Schedule of non-cash transactions</b>                                      |                                   |               |
| Real estate acquired in settlement of loans                                   | 343                               | 154           |
| Unrealized gain (loss) on securities, net of income taxes                     | (219)                             | 1,491         |

See notes to consolidated financial statements that are an integral part of these consolidated statements.





**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 Nature of Business and Basis of Presentation**

*Business Activity*

**Southern First Bancshares, Inc.** (the "Company") is a South Carolina corporation that owns all of the capital stock of Southern First Bank (the "Bank") and all of the stock of Greenville First Statutory Trust I and II (collectively, the "Trusts"). The Trusts are special purpose non-consolidated entities organized for the sole purpose of issuing trust preferred securities. The Bank's primary federal regulator is the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is also regulated and examined by the South Carolina Board of Financial Institutions. The Bank is primarily engaged in the business of accepting demand deposits and savings deposits insured by the FDIC, and providing commercial, consumer and mortgage loans to the general public.

*Basis of Presentation*

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. 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, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 as filed with the Securities and Exchange Commission on March 3, 2015. The consolidated financial statements include the accounts of the Company and the Bank. In accordance with Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 810, Consolidation, the financial statements related to the Trusts have not been consolidated.

*Use of Estimates*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of income and expenses during the reporting periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, real estate acquired in the settlement of loans, fair value of financial instruments, evaluating other-than-temporary-impairment of investment securities and valuation of deferred tax assets.

*Reclassifications*

Certain amounts, previously reported, have been reclassified to state all periods on a comparable basis and had no effect on shareholders' equity or net income.

*Subsequent Events*

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management performed an evaluation to determine whether there have been any subsequent events since the balance sheet date and determined that no subsequent events occurred requiring accrual or disclosure.

**NOTE 2 Preferred and Common Stock**

On November 12, 2014, the Company issued 1,380,000 shares of its common stock in a public offering at \$14.40 per share, including 180,000 shares which were sold to the underwriter pursuant to an option to purchase additional shares to cover any over-allotments. The net proceeds from the offering totaled approximately \$18.4 million, after deducting the underwriting discount as well as estimated offering expenses.

Using proceeds from the public offering, on December 12, 2014, the Company completed the repurchase of the remaining 11,242 shares of Series T preferred stock outstanding at \$1,000 par value from third party investors who purchased the shares in July 2012 through a Dutch auction conducted by the U.S. Treasury. As of December 31, 2014, the Company has no shares of preferred stock outstanding.

**NOTE 3 Investment Securities**

The amortized costs and fair value of investment securities are as follows:

| (dollars in thousands)                         | Amortized Cost | Gross Unrealized |        | June 30, 2015 |
|--|----------------|------------------|--------|---------------|
|  |                | Gains            | Losses | Fair Value    |
| <b>Available for sale</b>                      |                |                  |        |               |
| US government agencies                         | \$ 9,133       | 18               | 307    | 8,844         |
| SBA securities                                 | 5,072          | -                | 169    | 4,903         |
| State and political subdivisions               | 16,148         | 325              | 127    | 16,346        |
| Mortgage-backed securities                     | 21,281         | 250              | 159    | 21,372        |
| Total investment securities available for sale | \$ 51,634      | 593              | 762    | 51,465        |

| (dollars in thousands)                         | Amortized Cost | Gross Unrealized |        | December 31, 2014 |
|--|----------------|------------------|--------|-------------------|
|  |                | Gains            | Losses | Fair Value        |
| <b>Available for sale</b>                      |                |                  |        |                   |
| US government agencies                         | \$ 8,763       | 9                | 215    | 8,557             |
| SBA securities                                 | 5,336          | -                | 182    | 5,154             |
| State and political subdivisions               | 16,253         | 598              | 51     | 16,800            |
| Mortgage-backed securities                     | 24,214         | 341              | 42     | 24,513            |
| Total investment securities available for sale | \$ 54,566      | 948              | 490    | 55,024            |

During the first quarter of 2015, the Company developed a need for additional liquidity as it experienced increased loan demand and, as a result, sold \$5.8 million of its mortgage-backed securities and state and municipal obligations and recorded a net gain on sale of investment securities of \$259,000. During the second quarter of 2015, we sold and subsequently reinvested \$4.3 million of investment securities, recording a gain of \$36,000 from the transaction.

Contractual maturities and yields on the Company's investment securities at June 30, 2015 and December 31, 2014 are shown in the following table. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (dollars in thousands)           | Less than one year |       | One to five years |       | Five to ten years |       | Over ten years |       | June 30, 2015 Total |       |
|----------------------------------|--------------------|-------|-------------------|-------|-------------------|-------|----------------|-------|---------------------|-------|
|                                  | Amount             | Yield | Amount            | Yield | Amount            | Yield | Amount         | Yield | Amount              | Yield |
| <b>Available for sale</b>        |                    |       |                   |       |                   |       |                |       |                     |       |
| US government agencies           | \$ -               | -     | -                 | -     | 1,316             | 2.19% | 7,528          | 2.42% | 8,844               | 2.39% |
| SBA securities                   | -                  | -     | -                 | -     | -                 | -     | 4,903          | 1.88% | 4,903               | 1.88% |
| State and political subdivisions | 2,063              | 0.84% | -                 | -     | 7,529             | 3.07% | 6,754          | 2.92% | 16,346              | 2.72% |
| Mortgage-backed securities       | -                  | -     | -                 | -     | 1,155             | 1.77% | 20,217         | 2.12% | 21,372              | 2.10% |
| Total                            | \$ 2,063           | 0.84% | -                 | -     | 10,000            | 2.79% | 39,402         | 2.28% | 51,465              | 2.32% |

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December 31, 2014

|                                  | Less than one year |       | One to five years |       | Five to ten years |       | Over ten years |       | Total  |       |
|----------------------------------|--------------------|-------|-------------------|-------|-------------------|-------|----------------|-------|--------|-------|
|                                  | Amount             | Yield | Amount            | Yield | Amount            | Yield | Amount         | Yield | Amount | Yield |
| <b>Available for sale</b>        |                    |       |                   |       |                   |       |                |       |        |       |
| US government agencies           | \$ -               | -     | 988               | 2.12% | -                 | -     | 7,569          | 2.43% | 8,557  | 2.39% |
| SBA securities                   | -                  | -     | -                 | -     | -                 | -     | 5,154          | 1.88% | 5,154  | 1.88% |
| State and political subdivisions | 2,082              | 0.68% | 399               | 3.14% | 8,465             | 3.23% | 5,854          | 3.00% | 16,800 | 2.82% |
| Mortgage-backed securities       | -                  | -     | -                 | -     | 2,118             | 1.66% | 22,395         | 2.62% | 24,513 | 2.54% |
| Total                            | \$ 2,082           | 0.68% | 1,387             | 2.41% | 10,583            | 2.91% | 40,972         | 2.54% | 55,024 | 2.54% |

The tables below summarize gross unrealized losses on investment securities and the fair market value of the related securities at June 30, 2015 and December 31, 2014, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

| (dollars in thousands)           | Less than 12 months |            |                   | 12 months or longer |            |                   | June 30, 2015 |                  |                         |
|----------------------------------|---------------------|------------|-------------------|---------------------|------------|-------------------|---------------|------------------|-------------------------|
|                                  | #                   | Fair value | Unrealized losses | #                   | Fair value | Unrealized losses | #             | Total Fair value | Total Unrealized losses |
| <b>Available for sale</b>        |                     |            |                   |                     |            |                   |               |                  |                         |
| US government agencies           | 3                   | \$ 8,826   | \$ 307            | -                   | \$ -       | \$ -              | 3             | \$ 8,826         | \$ 307                  |
| SBA securities                   | -                   | -          | -                 | 2                   | 4,903      | 169               | 2             | 4,903            | 169                     |
| State and political subdivisions | 6                   | 2,422      | 69                | 4                   | 2,226      | 58                | 10            | 4,648            | 127                     |
| Mortgage-backed securities       | 8                   | 11,592     | 159               | -                   | -          | -                 | 8             | 11,592           | 159                     |
| Total                            | 17                  | \$ 22,840  | \$ 535            | 6                   | \$ 7,129   | \$ 227            | 23            | \$ 29,969        | \$ 762                  |

|                                  | Less than 12 months |            |                   | 12 months or longer |            |                   | December 31, 2014 |                  |                         |
|----------------------------------|---------------------|------------|-------------------|---------------------|------------|-------------------|-------------------|------------------|-------------------------|
|                                  | #                   | Fair value | Unrealized losses | #                   | Fair value | Unrealized losses | #                 | Total Fair value | Total Unrealized losses |
| <b>Available for sale</b>        |                     |            |                   |                     |            |                   |                   |                  |                         |
| US government agencies           | -                   | \$ -       | \$ -              | 2                   | \$ 7,569   | \$ 215            | 2                 | \$ 7,569         | \$ 215                  |
| SBA securities                   | -                   | -          | -                 | 2                   | 5,154      | 182               | 2                 | 5,154            | 182                     |
| State and political subdivisions | -                   | -          | -                 | 7                   | 3,488      | 51                | 7                 | 3,488            | 51                      |
| Mortgage-backed securities       | 3                   | 4,407      | 11                | 2                   | 4,756      | 31                | 5                 | 9,163            | 42                      |
| Total                            | 3                   | \$ 4,407   | \$ 11             | 13                  | \$ 20,967  | \$ 479            | 16                | \$ 25,374        | \$ 490                  |

At June 30, 2015, the Company had 17 individual investments with a fair market value of \$22.8 million that were in an unrealized loss position for less than 12 months and six individual investments with a fair market value of \$7.1 million that were in an unrealized loss position for 12 months or longer. The unrealized losses were primarily attributable to changes in interest rates, rather than deterioration in credit quality. The individual securities are each investment grade securities. The Company considers the length of time and extent to which the fair value of available-for-sale debt securities have been less than cost to conclude that such securities are not other-than-temporarily impaired. We also consider other factors such as the financial condition of the issuer including credit ratings and specific events affecting the operations of the issuer, volatility of the security, underlying assets that collateralize the debt security, and other industry and macroeconomic conditions. As the Company has no intent to sell securities with unrealized losses and it is not more-likely-than-not that the Company will be required to sell these securities before recovery of amortized cost, we have concluded that these securities are not impaired on an other-than-temporary basis.

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Other investments are comprised of the following and are recorded at cost which approximates fair value.

| (dollars in thousands)                   | June 30,<br>2015 | December 31, 2014 |
|--|------------------|-------------------|
| Federal Home Loan Bank stock             | \$ 5,005         | 6,020             |
| Investment in Trust Preferred securities | 403              | 403               |
| Other investments                        | 124              | 99                |
| Total other investments                  | \$ 5,532         | 6,522             |

The Company has evaluated the Federal Home Loan Bank ( FHLB ) stock for impairment and determined that the investment in the FHLB stock is not other than temporarily impaired as of June 30, 2015 and ultimate recoverability of the par value of this investment is probable. All of the FHLB stock is used to collateralize advances with the FHLB.

At June 30, 2015, \$21.3 million of securities were pledged as collateral for repurchase agreements from brokers, and approximately \$12.2 million of securities were pledged to secure client deposits. At December 31, 2014, \$21.8 million of securities were pledged as collateral for repurchase agreements from brokers, and approximately \$12.9 million of securities were pledged to secure client deposits.

**NOTE 4 Loans and Allowance for Loan Losses**

The following table summarizes the composition of our loan portfolio. Total gross loans are recorded net of deferred loan fees and costs, which totaled \$1.9 million and \$1.8 million as of June 30, 2015 and December 31, 2014, respectively.

| (dollars in thousands)                  | June 30, 2015 |            | December 31, 2014 |            |
|---|---------------|------------|-------------------|------------|
|   | Amount        | % of Total | Amount            | % of Total |
| <b>Commercial</b>                       |               |            |                   |            |
| Owner occupied RE                       | \$232,997     | 24.2%      | \$191,061         | 21.9%      |
| Non-owner occupied RE                   | 207,623       | 21.6%      | 183,440           | 21.1%      |
| Construction                            | 33,570        | 3.5%       | 50,995            | 5.8%       |
| Business                                | 162,017       | 16.8%      | 149,986           | 17.2%      |
| Total commercial loans                  | 636,207       | 66.1%      | 575,482           | 66.0%      |
| <b>Consumer</b>                         |               |            |                   |            |
| Real estate                             | 166,404       | 17.3%      | 146,859           | 16.9%      |
| Home equity                             | 105,241       | 10.9%      | 95,629            | 11.0%      |
| Construction                            | 40,957        | 4.2%       | 39,226            | 4.5%       |
| Other                                   | 14,687        | 1.5%       | 14,250            | 1.6%       |
| Total consumer loans                    | 327,289       | 33.9%      | 295,964           | 34.0%      |
| Total gross loans, net of deferred fees | 963,496       | 100.0%     | 871,446           | 100.0%     |
| Less allowance for loan losses          | (12,927)      |            | (11,752)          |            |
| Total loans, net                        | \$950,569     |            | \$859,694         |            |

*Maturities and Sensitivity of Loans to Changes in Interest Rates*

The information in the following tables summarizes the loan maturity distribution by type and related interest rate characteristics based on the contractual maturities of individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon maturity. Actual repayments of loans may differ from the maturities reflected below, because borrowers have the right to prepay obligations with or without prepayment penalties.

June 30, 2015

| (dollars in thousands)                  | One year<br>or less | After one<br>but within<br>five years | After five<br>years | Total      |
|---|---------------------|---------------------------------------|---------------------|------------|
| <b>Commercial</b>                       |                     |                                       |                     |            |
| Owner occupied RE                       | \$ 22,954           | 125,545                               | 84,498              | 232,997    |
| Non-owner occupied RE                   | 38,321              | 132,549                               | 36,753              | 207,623    |
| Construction                            | 13,429              | 15,467                                | 4,674               | 33,570     |
| Business                                | 72,776              | 76,802                                | 12,439              | 162,017    |
| Total commercial loans                  | 147,480             | 350,363                               | 138,364             | 636,207    |
| <b>Consumer</b>                         |                     |                                       |                     |            |
| Real estate                             | 25,794              | 42,669                                | 97,941              | 166,404    |
| Home equity                             | 6,151               | 31,292                                | 67,798              | 105,241    |
| Construction                            | 17,578              | 2,623                                 | 20,756              | 40,957     |
| Other                                   | 7,409               | 5,787                                 | 1,491               | 14,687     |
| Total consumer loans                    | 56,932              | 82,371                                | 187,986             | 327,289    |
| Total gross loans, net of deferred fees | \$ 204,412          | 432,734                               | 326,350             | 963,496    |
| Loans maturing after one year with:     |                     |                                       |                     |            |
| Fixed interest rates                    |                     |                                       |                     | \$ 560,046 |
| Floating interest rates                 |                     |                                       |                     | 199,038    |

December 31, 2014

|  | One year<br>or less | After one<br>but within<br>five years | After five<br>years | Total   |
|--|---------------------|---------------------------------------|---------------------|---------|
| <b>Commercial</b>                      |                     |                                       |                     |         |
| Owner occupied RE                      | \$ 20,737           | 98,110                                | 72,214              | 191,061 |
| Non-owner occupied RE                  | 46,718              | 104,402                               | 32,320              | 183,440 |
| Construction                           | 11,923              | 25,145                                | 13,927              | 50,995  |
| Business                               | 75,718              | 65,899                                | 8,369               | 149,986 |
| Total commercial loans                 | 155,096             | 293,556                               | 126,830             | 575,482 |
| <b>Consumer</b>                        |                     |                                       |                     |         |
| Real estate                            | 21,571              | 41,549                                | 83,739              | 146,859 |
| Home equity                            | 5,645               | 28,394                                | 61,590              | 95,629  |
| Construction                           | 13,531              | 2,073                                 | 23,622              | 39,226  |
| Other                                  | 7,278               | 5,637                                 | 1,335               | 14,250  |
| Total consumer                         | 48,025              | 77,653                                | 170,286             | 295,964 |
| Total gross loan, net of deferred fees | \$ 203,121          | 371,209                               | 297,116             | 871,446 |
| Loans maturing after one year with :   |                     |                                       |                     |         |
| Fixed interest rates                   |                     |                                       |                     | 494,058 |
| Floating interest rates                |                     |                                       |                     | 174,267 |

### Portfolio Segment Methodology

#### Commercial

Commercial loans are assessed for estimated losses by grading each loan using various risk factors identified through periodic reviews. We apply historic grade-specific loss factors to each loan class. In the development of our statistically derived loan grade loss factors, we observe historical losses over 12 quarters for each loan grade. These loss estimates are adjusted as appropriate based on additional analysis of external loss data or other risks identified from current economic conditions and credit quality trends. The allowance also includes an amount for the estimated impairment on nonaccrual commercial loans and commercial loans modified in a troubled debt restructuring ( TDR ), whether on accrual or nonaccrual status.

*Consumer*

For consumer loans, we determine the allowance on a collective basis utilizing historical losses over 12 quarters to represent our best estimate of inherent loss. We pool loans, generally by loan class with similar risk characteristics. The allowance also includes an amount for the estimated impairment on nonaccrual consumer loans and consumer loans modified in a TDR, whether on accrual or nonaccrual status.

**Credit Quality Indicators***Commercial*

We manage a consistent process for assessing commercial loan credit quality by monitoring our loan grading trends and past due statistics. All loans are subject to individual risk assessment. Our risk categories include Pass, Special Mention, Substandard, and Doubtful, each of which is defined by banking regulatory agencies. Delinquency statistics are also an important indicator of credit quality in the establishment of our allowance for credit losses.

We categorize our loans into risk categories based on relevant information about the ability of the borrower to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. A description of the general characteristics of the risk grades is as follows:

**Pass** These loans range from minimal credit risk to average however still acceptable credit risk.

**Special mention** A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the institution's credit position at some future date.

**Substandard** A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness, or weaknesses, that may jeopardize the liquidation of the debt. A substandard loan is characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

**Doubtful** A doubtful loan has all of the weaknesses inherent in one classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of the currently existing facts, conditions and values, highly questionable and improbable.

The tables below provide a breakdown of outstanding commercial loans by risk category.

|                        | June 30, 2015           |                          |              |          |         |
|------------------------|-------------------------|--------------------------|--------------|----------|---------|
|                        | Owner<br>occupied<br>RE | Non-owner<br>occupied RE | Construction | Business | Total   |
| (dollars in thousands) |                         |                          |              |          |         |
| Pass                   | \$227,441               | 197,847                  | 31,639       | 152,923  | 609,850 |
| Special mention        | 3,774                   | 3,326                    | -            | 4,935    | 12,035  |
| Substandard            | 1,782                   | 6,450                    | 1,931        | 4,159    | 14,322  |
| Doubtful               | -                       | -                        | -            | -        | -       |
|                        | \$232,997               | 207,623                  | 33,570       | 162,017  | 636,207 |

December 31, 2014

|                 | Owner<br>occupied<br>RE | Non-owner<br>occupied RE | Construction | Business | Total   |
|-----------------|-------------------------|--------------------------|--------------|----------|---------|
| Pass            | \$ 184,158              | 173,711                  | 48,140       | 140,432  | 546,441 |
| Special mention | 5,035                   | 3,376                    | 129          | 4,715    | 13,255  |
| Substandard     | 1,868                   | 6,353                    | 2,726        | 4,839    | 15,786  |
| Doubtful        | -                       | -                        | -            | -        | -       |
|                 | \$ 191,061              | 183,440                  | 50,995       | 149,986  | 575,482 |

The following tables provide past due information for outstanding commercial loans and include loans on nonaccrual status as well as accruing TDRs.

June 30, 2015

| (dollars in thousands) | Owner<br>occupied RE | Non-owner<br>occupied RE | Construction | Business | Total   |
|------------------------|----------------------|--------------------------|--------------|----------|---------|
| Current                | \$ 232,277           | 202,967                  | 33,038       | 160,363  | 628,645 |
| 30-59 days past due    | -                    | 1,452                    | -            | 252      | 1,704   |
| 60-89 days past due    | -                    | -                        | -            | 14       | 14      |
| Greater than 90 Days   | 720                  | 3,204                    | 532          | 1,388    | 5,844   |
|                        | \$ 232,997           | 207,623                  | 33,570       | 162,017  | 636,207 |

December 31, 2014

|                      | Owner<br>occupied RE | Non-owner<br>occupied RE | Construction | Business | Total   |
|----------------------|----------------------|--------------------------|--------------|----------|---------|
| Current              | \$ 190,801           | 180,577                  | 50,212       | 148,317  | 569,907 |
| 30-59 days past due  | -                    | 49                       | -            | 35       | 84      |
| 60-89 days past due  | -                    | 246                      | -            | 155      | 401     |
| Greater than 90 Days | 260                  | 2,568                    | 783          | 1,479    | 5,090   |
|                      | \$ 191,061           | 183,440                  | 50,995       | 149,986  | 575,482 |

As of June 30, 2015 and December 31, 2014, loans 30 days or more past due represented 0.97% and 0.73% of our total loan portfolio, respectively. Commercial loans 30 days or more past due were 0.78% and 0.64% of our total loan portfolio as of June 30, 2015 and December 31, 2014, respectively.

#### Consumer

We manage a consistent process for assessing consumer loan credit quality by monitoring our loan grading trends and past due statistics. All loans are subject to individual risk assessment. Our categories include Pass, Special Mention, Substandard, and Doubtful, which are defined above. Delinquency statistics are also an important indicator of credit quality in the establishment of our allowance for loan losses.

The tables below provide a breakdown of outstanding consumer loans by risk category.

June 30, 2015

| (dollars in thousands) | Real<br>estate | Home equity | Construction | Other  | Total   |
|------------------------|----------------|-------------|--------------|--------|---------|
| Pass                   | \$ 163,612     | 101,210     | 40,957       | 14,523 | 320,302 |
| Special mention        | 790            | 2,976       | -            | 135    | 3,901   |
| Substandard            | 2,002          | 1,055       | -            | 29     | 3,086   |
| Doubtful               | -              | -           | -            | -      | -       |
|                        | \$ 166,404     | 105,241     | 40,957       | 14,687 | 327,289 |





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|                 | December 31, 2014 |             |              |        |         |
|-----------------|-------------------|-------------|--------------|--------|---------|
|                 | Real estate       | Home equity | Construction | Other  | Total   |
| Pass            | \$ 144,070        | 91,084      | 39,226       | 14,013 | 288,393 |
| Special mention | 953               | 3,268       | -            | 139    | 4,360   |
| Substandard     | 1,836             | 1,277       | -            | 98     | 3,211   |
| Doubtful        | -                 | -           | -            | -      | -       |
|                 | \$ 146,859        | 95,629      | 39,226       | 14,250 | 295,964 |

The following tables provide past due information for outstanding consumer loans and include loans on nonaccrual status as well as accruing TDRs.

|                        | June 30, 2015 |             |              |        |         |
|------------------------|---------------|-------------|--------------|--------|---------|
| (dollars in thousands) | Real estate   | Home equity | Construction | Other  | Total   |
| Current                | \$ 165,065    | 104,846     | 40,957       | 14,632 | 325,500 |
| 30-59 days past due    | 455           | 145         | -            | 51     | 651     |
| 60-89 days past due    | 465           | 130         | -            | 4      | 599     |
| Greater than 90 Days   | 419           | 120         | -            | -      | 539     |
|                        | \$ 166,404    | 105,241     | 40,957       | 14,687 | 327,289 |

|                      | December 31, 2014 |             |              |        |         |
|----------------------|-------------------|-------------|--------------|--------|---------|
|                      | Real estate       | Home equity | Construction | Other  | Total   |
| Current              | \$ 146,362        | 95,311      | 39,226       | 14,247 | 294,146 |
| 30-59 days past due  | 40                | -           | -            | -      | 40      |
| 60-89 days past due  | -                 | 130         | -            | 3      | 133     |
| Greater than 90 Days | 457               | 188         | -            | -      | 645     |
|                      | \$ 146,859        | 95,629      | 39,226       | 14,250 | 295,964 |

As of June 30, 2015 and December 31, 2014, consumer loans 30 days or more past due were 0.19% and 0.09%, respectively, of total loans.

### Nonperforming assets

The following table shows the nonperforming assets and the related percentage of nonperforming assets to total assets and gross loans. Generally, a loan is placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when we believe, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of the contractual principal or interest on the loan is doubtful. A payment of interest on a loan that is classified as nonaccrual is recognized as a reduction in principal when received.

Following is a summary of our nonperforming assets, including nonaccruing TDRs.

| (dollars in thousands)                             | June 30,<br>2015 | December 31, 2014 |
|--|------------------|-------------------|
| <b>Commercial</b>                                  |                  |                   |
| Owner occupied RE                                  | \$ 720           | 322               |
| Non-owner occupied RE                              | 3,018            | 2,344             |
| Construction                                       | -                | 783               |
| Business   | 1,178            | 1,408             |
| <b>Consumer</b>                                    |                  |                   |
| Real estate  | 419              | 457               |
| Home equity  | 250              | 188               |
| Construction                                       | -                | -                 |
| Other  | 1                | 1                 |
| Nonaccruing troubled debt restructurings           | 1,087            | 1,147             |
| Total nonaccrual loans, including nonaccruing TDRs | 6,673            | 6,650             |
| Other real estate owned                            | 2,887            | 3,307             |
| Total nonperforming assets                         | \$ 9,560         | 9,957             |
| Nonperforming assets as a percentage of:           |                  |                   |
| Total assets                                       | 0.85%            | 0.97%             |
| Gross loans  | 0.99%            | 1.14%             |
| Total loans over 90 days past due                  | 6,383            | 5,735             |
| Loans over 90 days past due and still accruing     | -                | -                 |
| Accruing troubled debt restructurings              | \$ 8,173         | 8,562             |

### Impaired Loans

The table below summarizes key information for impaired loans. Our impaired loans include loans on nonaccrual status and loans modified in a TDR, whether on accrual or nonaccrual status. These impaired loans may have estimated impairment which is included in the allowance for loan losses. Our commercial and consumer impaired loans are evaluated individually to determine the related allowance for loan losses.

| (dollars in thousands) | June 30, 2015                  |                   |   |   |
|------------------------|--------------------------------|-------------------|---|---|
|                        | Unpaid<br>Principal<br>Balance | Impaired<br>loans | Recorded investment<br>Impaired loans<br>with related<br>allowance for<br>loan losses | Related<br>allowance for<br>loan losses |
| <b>Commercial</b>      |                                |                   |   |   |
| Owner occupied RE      | \$ 1,531                       | 1,506             | 1,506   | 490                                     |
| Non-owner occupied RE  | 8,342                          | 4,997             | 3,091   | 778                                     |
| Construction           | 1,931                          | 1,931             | 532   | 166                                     |
| Business               | 4,591                          | 4,126             | 2,946   | 2,266                                   |
| Total commercial       | 16,395                         | 12,560            | 8,075   | 3,700                                   |
| <b>Consumer</b>        |                                |                   |   |   |
| Real estate            | 1,702                          | 1,664             | 1,346   | 631                                     |
| Home equity            | 406                            | 406               | 157   | 157                                     |
| Construction           | -                              | -                 | -   | -                                       |
| Other                  | 216                            | 216               | 216   | 216                                     |
| Total consumer         | 2,324                          | 2,286             | 1,719   | 1,004                                   |
| Total                  | \$ 18,719                      | 14,846            | 9,794   | 4,704                                   |

|                       | December 31, 2014              |                   |   |   |
|-----------------------|--------------------------------|-------------------|---|---|
|                       | Unpaid<br>Principal<br>Balance | Impaired<br>loans | Recorded investment<br>Impaired loans<br>with related<br>allowance for<br>loan losses | Related<br>allowance for<br>loan losses |
| <b>Commercial</b>     |                                |                   |   |   |
| Owner occupied RE     | \$ 1,122                       | 1,122             | 1,060   | 371                                     |
| Non-owner occupied RE | 5,813                          | 4,522             | 2,777   | 801                                     |
| Construction          | 5,268                          | 2,726             | 1,315   | 324                                     |
| Business              | 5,385                          | 4,565             | 3,528   | 2,464                                   |
| Total commercial      | 17,588                         | 12,935            | 8,680   | 3,960                                   |
| <b>Consumer</b>       |                                |                   |   |   |
| Real estate           | 1,620                          | 1,620             | 1,299   | 585                                     |
| Home equity           | 347                            | 347               | 347   | 191                                     |
| Construction          | -                              | -                 | -   | -                                       |
| Other                 | 310                            | 310               | 310   | 310                                     |
| Total consumer        | 2,277                          | 2,277             | 1,956   | 1,086                                   |
| Total                 | \$19,865                       | 15,212            | 10,636  | 5,046                                   |

The following table provides the average recorded investment in impaired loans and the amount of interest income recognized on impaired loans after impairment by portfolio segment and class.

|                        | Three months ended<br>June 30, 2015 |                                  | Three months ended<br>June 30, 2014 |                                   |
|------------------------|-------------------------------------|----------------------------------|-------------------------------------|-----------------------------------|
|                        | Average<br>recorded<br>investment   | Recognized<br>interest<br>income | Average<br>recorded<br>investment   | Average<br>recorded<br>investment |
| (dollars in thousands) |                                     |                                  |                                     |                                   |
| <b>Commercial</b>      |                                     |                                  |                                     |                                   |
| Owner occupied RE      | \$ 1,292                            | 10                               | 1,662                               | 2                                 |
| Non-owner occupied RE  | 5,153                               | 24                               | 6,646                               | 22                                |
| Construction           | 1,935                               | 23                               | 1,768                               | -                                 |
| Business               | 4,194                               | 33                               | 4,713                               | 42                                |
| Total commercial       | 12,574                              | 90                               | 14,789                              | 66                                |
| <b>Consumer</b>        |                                     |                                  |                                     |                                   |
| Real estate            | 1,685                               | 12                               | 2,355                               | 12                                |
| Home equity            | 376                                 | 8                                | 161                                 | 2                                 |
| Construction           | -                                   | -                                | -                                   | -                                 |
| Other                  | 219                                 | 2                                | 277                                 | 3                                 |
| Total consumer         | 2,280                               | 22                               | 2,793                               | 17                                |
| Total                  | \$ 14,854                           | 112                              | 17,582                              | 83                                |

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| (dollars in thousands) | Six months ended<br>June 30, 2015 |                                  | Six months ended<br>June 30, 2014 |                                  | Year ended<br>December 31, 2014   |                                  |
|------------------------|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|                        | Average<br>recorded<br>investment | Recognized<br>interest<br>income | Average<br>recorded<br>investment | Recognized<br>interest<br>income | Average<br>recorded<br>investment | Recognized<br>interest<br>income |
| <b>Commercial</b>      |                                   |                                  |                                   |                                  |                                   |                                  |
| Owner occupied RE      | \$ 1,236                          | 31                               | 1,753                             | 3                                | 1,568                             | 47                               |
| Non-owner occupied RE  | 4,942                             | 47                               | 6,305                             | 53                               | 5,693                             | 104                              |
| Construction           | 2,198                             | 41                               | 1,802                             | 14                               | 1,977                             | 75                               |
| Business               | 4,318                             | 70                               | 4,703                             | 83                               | 4,522                             | 154                              |
| Total commercial       | 12,694                            | 189                              | 14,563                            | 153                              | 13,760                            | 380                              |
| <b>Consumer</b>        |                                   |                                  |                                   |                                  |                                   |                                  |
| Real estate            | 1,664                             | 24                               | 2,172                             | 25                               | 2,094                             | 53                               |
| Home equity            | 366                               | 9                                | 187                               | 4                                | 251                               | 10                               |
| Construction           | -                                 | -                                | -                                 | -                                | -                                 | -                                |
| Other                  | 249                               | 4                                | 260                               | 5                                | 282                               | 13                               |
| Total consumer         | 2,279                             | 37                               | 2,619                             | 34                               | 2,627                             | 76                               |
| Total                  | \$ 14,973                         | 226                              | 17,182                            | 187                              | 16,387                            | 456                              |

### Allowance for Loan Losses

The allowance for loan loss is management's estimate of credit losses inherent in the loan portfolio. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

We have an established process to determine the adequacy of the allowance for loan losses that assesses the losses inherent in our portfolio. While we attribute portions of the allowance to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. Our process involves procedures to appropriately consider the unique risk characteristics of our commercial and consumer loan portfolio segments. For each portfolio segment, impairment is measured individually for each impaired loan. Our allowance levels are influenced by loan volume, loan grade or delinquency status, historic loss experience and other economic conditions.

The following table summarizes the activity related to our allowance for loan losses by commercial and consumer portfolio segments:

| (dollars in thousands)       | Six months ended June 30, 2015 |                             |              |          |                |                |              |       |        |
|------------------------------|--------------------------------|-----------------------------|--------------|----------|----------------|----------------|--------------|-------|--------|
|                              | Commercial                     |                             |              |          |                | Consumer       |              |       |        |
|                              | Owner<br>occupied<br>RE        | Non-owner<br>occupied<br>RE | Construction | Business | Real<br>Estate | Home<br>equity | Construction | Other | Total  |
| Balance, beginning of period | \$ 1,645                       | 2,332                       | 614          | 3,625    | 1,714          | 1,162          | 236          | 424   | 11,752 |
| Provision for loan losses    | 643                            | 574                         | (216)        | 272      | 263            | 131            | 36           | (78)  | 1,625  |
| Loan charge-offs             | (24)                           | (204)                       | -            | (218)    | (39)           | (13)           | -            | (1)   | (499)  |
| Loan recoveries              | -                              | 6                           | -            | 42       | -              | 1              | -            | -     | 49     |
| Net loan charge-offs         | (24)                           | (198)                       | -            | (176)    | (39)           | (12)           | -            | (1)   |        |