

SOUTHERN FIRST BANCSHARES INC

Form 10-Q

May 01, 2018

**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 March 31, 2018**

**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

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller Reporting Company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 7,381,716 shares of common stock, par value \$0.01 per share, were issued and outstanding as of April 25, 2018.

**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY**  
**March 31, 2018 Form 10-Q**

**INDEX**

<b>PART I – CONSOLIDATED FINANCIAL INFORMATION</b>		<b>Page</b>
Item 1.	Consolidated Financial Statements	
	Consolidated Balance Sheets	3
	Consolidated Statements of Income	4
	Consolidated Statements of Comprehensive Income	5
	Consolidated Statements of Shareholders' Equity	6
	Consolidated Statements of Cash Flows	7
	Notes to Unaudited Consolidated Financial Statements	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	26
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	40
Item 4.	Controls and Procedures	41
<b>PART II – OTHER INFORMATION</b>		
Item 1.	Legal Proceedings	41
Item 1A.	Risk Factors	41
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	41
Item 3.	Defaults upon Senior Securities	41
Item 4.	Mine Safety Disclosures	41
Item 5.	Other Information	41
Item 6.	Exhibits	41

**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)	<b>March 31, 2018 (Unaudited)</b>	<b>December 31, 2017 (Audited)</b>
<b>ASSETS</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 10,645	17,171
Federal funds sold	103,213	49,148
Interest-bearing deposits with banks	22,253	25,846
Total cash and cash equivalents	136,111	92,165
Investment securities:		
Investment securities available for sale	58,506	67,603
Other investments	3,056	4,462
Total investment securities	61,562	72,065
Mortgage loans held for sale	10,885	11,790
Loans	1,459,382	1,387,070
Less allowance for loan losses	(15,852)	(15,523)
Loans, net	1,443,530	1,371,547
Bank owned life insurance	33,352	33,132
Property and equipment, net	32,339	32,234
Deferred income taxes	3,975	3,782
Other assets	7,545	7,910
Total assets	\$ 1,729,299	1,624,625
<b>LIABILITIES</b>		
Deposits	\$ 1,520,523	1,381,123
Federal Home Loan Bank advances and other borrowings	28,600	67,200
Junior subordinated debentures	13,403	13,403
Other liabilities	12,034	13,213
Total liabilities	1,574,560	1,474,939
<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, 7,381,716 and 7,347,851 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively	74	73
Nonvested restricted stock	(842)	(502)
Additional paid-in capital	100,890	99,986
Accumulated other comprehensive loss	(1,182)	(456)
Retained earnings	55,799	50,585
Total shareholders' equity	154,739	149,686
Total liabilities and shareholders' equity	\$ 1,729,299	1,624,625
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 ended March 31,	
	2018	2017
(dollars in thousands, except share data)		
<b>Interest income</b>		
Loans	\$ 16,563	13,526
Investment securities	368	376
Federal funds sold	247	57
Total interest income	17,178	13,959
<b>Interest expense</b>		
Deposits	2,738	1,249
Borrowings	398	1,103
Total interest expense	3,136	2,352
Net interest income	14,042	11,607
Provision for loan losses	500	500
Net interest income after provision for loan losses	13,542	11,107
<b>Noninterest income</b>		
Mortgage banking income	1,328	1,057
Service fees on deposit accounts	257	278
ATM and debit card income	334	263
Income from bank owned life insurance	220	183
Other income	281	270
Total noninterest income	2,420	2,051
<b>Noninterest expenses</b>		
Compensation and benefits	5,843	5,273
Occupancy	1,137	967
Outside service and data processing costs	736	745
Insurance	313	289
Professional fees	476	313
Marketing	209	210
Other	491	563
Total noninterest expenses	9,205	8,360
Income before income tax expense	6,757	4,798
<b>Income tax expense</b>	1,543	1,686
<b>Net income available to common shareholders</b>	\$ 5,214	3,112
<b>Earnings per common share</b>		
Basic	\$ 0.71	0.48
Diluted	0.67	0.46
<b>Weighted average common shares outstanding</b>		
Basic	7,336,839	6,437,231
Diluted	7,726,885	6,829,590

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 ended March 31,	
	2018	2017
Net income	\$ 5,214	3,112
Other comprehensive income (loss):		
Unrealized gain (loss) on securities available for sale:		
Unrealized holding gain (loss) arising during the period, pretax	(918)	238
Tax (expense) benefit	192	(81 )
Other comprehensive income (loss)	(726 )	157
Comprehensive income	\$ 4,488	3,269

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 THREE MONTHS ENDED MARCH 31, 2018 AND 2017  
(Unaudited)**

(dollars in thousands, except share data)	Common stock		Preferred stock		Nonvested	Additional	Accumulated	Retained	Total
	Shares	Amount	Shares	Amount	restricted stock	paid-in capital	other comprehensive loss	earnings	
<b>December 31, 2016</b>	<b>6,463,789</b>	<b>65</b>	-	-	(600)	73,371	(504 )	37,540	109,872
Net income	-	-	-	-	-	-	-	3,112	3,112
Proceeds from exercise of stock options	13,250	-	-	-	-	112	-	-	112
Issuance of restricted stock	3,125	-	-	-	(146)	146	-	-	-
Amortization of deferred compensation on restricted stock	-	-	-	-	77	-	-	-	77
Compensation expense related to stock options, net of tax	-	-	-	-	-	236	-	-	236
Other comprehensive income	-	-	-	-	-	-	157	-	157
<b>March 31, 2017</b>	<b>6,480,164</b>	<b>\$ 65</b>	-	\$ -	(669)	\$ 73,865	\$ (347 )	\$ 40,652	\$ 113,566
<b>December 31, 2017</b>	<b>7,347,851</b>	<b>73</b>	-	-	(502)	99,986	(456 )	50,585	149,686
Net income	-	-	-	-	-	-	-	5,214	5,214
Proceeds from exercise of stock options	24,365	1	-	-	-	227	-	-	228
Issuance of restricted stock	9,500	-	-	-	(409)	409	-	-	-
Amortization of deferred compensation on restricted stock	-	-	-	-	69	-	-	-	69
Compensation expense related to stock options, net of tax	-	-	-	-	-	268	-	-	268
Other comprehensive loss	-	-	-	-	-	-	(726 )	-	(726 )
<b>March 31, 2018</b>	<b>7,381,716</b>	<b>\$ 74</b>	-	\$ -	(842)	\$ 100,890	\$ (1,182 )	\$ 55,799	\$ 154,739

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)

	For the three months ended March	
	2018	31, 2017
(dollars in thousands)		
<b>Operating activities</b>		
Net income	\$ 5,214	\$ 3,112
Adjustments to reconcile net income to cash provided by (used for) operating activities:		
Provision for loan losses	500	500
Depreciation and other amortization	401	309
Accretion and amortization of securities discounts and premium, net	116	132
Loss on sale of investment securities available for sale	1	-
Gain on sale of fixed assets	(8)	-
Compensation expense related to stock options and restricted stock grants	337	313
Gain on sale of loans held for sale	(941)	(1,001)
Loans originated and held for sale	(49,194)	(36,570)
Proceeds from sale of loans held for sale	51,040	37,920
Increase in cash surrender value of bank owned life insurance	(220)	(183)
(Increase) decrease in deferred tax asset	(1)	1,714
Decrease in other assets, net	365	87
Increase (decrease) in other liabilities	(1,179)	713
Net cash provided by operating activities	6,431	7,046
<b>Investing activities</b>		
Increase (decrease) in cash realized from:		
Origination of loans, net	(72,483)	(55,134)
Purchase of property and equipment	(498)	(1,937)
Purchase of investment securities:		
Other	(2,595)	(1,386)
Payments and maturities, calls and repayments of investment securities:		
Available for sale	2,221	1,751
Other	4,001	1,605
Proceeds from sale of investment securities available for sale	5,841	-
Net cash used for investing activities	(63,513)	(55,101)
<b>Financing activities</b>		
Increase (decrease) in cash realized from:		
Increase in deposits, net	139,400	120,123
Increase (decrease) in Federal Home Loan Bank advances and other borrowings, net	(38,600)	2,500
Proceeds from the exercise of stock options and warrants	228	112
Net cash provided by financing activities	101,028	122,735
Net increase in cash and cash equivalents	43,946	74,680
<b>Cash and cash equivalents at beginning of the period</b>	92,165	46,552
<b>Cash and cash equivalents at end of the period</b>	\$ 136,111	\$ 121,232
<b>Supplemental information</b>		
<b>Cash paid for</b>		
Interest	\$ 3,190	\$ 2,339
Income taxes	-	-
<b>Schedule of non-cash transactions</b>		
Unrealized gain (loss) on securities, net of income taxes	(726)	157

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 month period ended March 31, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. 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, 2017 as filed with the Securities and Exchange Commission on February 28, 2018. 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.

*Business Segments*

In determining proper segment definition, the Company considers the materiality of a potential segment and components of the business about which financial information is available and regularly evaluated, relative to a resource allocation and performance assessment. The Company accounts for intersegment revenues and expenses as if the revenue/expense transactions were generated to third parties, that is, at current market prices. Please refer to "Note 9 – Reportable Segments" for further information on the reporting for the Company's three business segments.

*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.

*Revenue from Contracts with Customers*

The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, "Revenue from Contracts with Customers" ("Topic 606"). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods.

The Company's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Our accounting policies will not change materially since the principles of revenue recognition from the Accounting Standards Update are largely consistent with existing guidance and current practices applied by our business. The following is a discussion of revenues within the scope of the new guidance:

*Service fees on deposit accounts* - The Company earns fees from its deposit clients for various services transaction-based, account maintenance, and overdraft or non-sufficient funds ("NSF") services. Transaction-based fees, which include services such as stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the client's request. Account maintenance fees, which relate primarily to monthly maintenance and account management, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft and NSF fees are recognized at the point in time that the overdraft occurs or the NSF item is presented. Service charges on deposits are withdrawn from the client's account balance.

*ATM and debit card income* - The Company earns interchange fees from debit cardholder transactions conducted through the payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

*Income Taxes*

On December 22, 2017, the United States enacted tax reform legislation commonly known as the Tax Cuts and Jobs Act (the "Tax Act"), resulting in significant modifications to existing law. Authoritative guidance and interpretation by regulatory bodies is ongoing, and as such, the accounting for the effects of the Tax Act is not final and the full impact of the new regulation is still being evaluated. The accounting is expected to be complete when the 2017 U.S. corporate income tax return is filed later in 2018.

*Adoption of New Accounting Standards*

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaces most existing revenue recognition guidance in GAAP. The new standard was effective for the Company on January 1, 2018. Adoption of ASU 2014-09 did not have a material impact on the Company's consolidated financial statements and related disclosures as the Company's primary sources of revenues are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of ASU 2014-09. The Company's revenue recognition pattern for revenue streams within the scope of ASU 2014-09, including but not limited to service charges on deposit accounts and gains/losses on the sale of other real estate owned, did not change significantly from current practice. The standard permits the use of either the full retrospective or modified retrospective transition method. The Company elected to use the modified retrospective transition method which requires application of ASU 2014-09 to uncompleted contracts at the date of adoption however, periods prior to the date of adoption will not be retrospectively revised as the impact of the ASU on uncompleted contracts at the date of adoption was not material.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"). The guidance affects the accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements of financial instruments. ASU 2016-01 was effective for the Company on January 1, 2018 and resulted in the use of an exit price rather than an entrance price to determine the fair value of loans not measured at fair value on a non-recurring basis in the consolidated balance sheets. See Note 7 – Fair Value Accounting for further information regarding the valuation of these loans.

## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

In February 2018, the FASB Issued (ASU 2018-02), Income Statement (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which requires Companies to reclassify the stranded effects in other comprehensive income to retained earnings as a result of the change in the tax rates under the Tax Cuts and Jobs Act. The Company has opted to early adopt this pronouncement by retrospective application to each period (or periods) in which the effect of the change in the tax rate under the Tax Act is recognized. The impact of the reclassification from other comprehensive income to retained earnings did not have a material effect on the Company's financial statements.

*Newly Issued, But Not Yet Effective Accounting Standards*

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). The FASB issued this ASU to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet by lessees for those leases classified as operating leases under current U.S. GAAP and disclosing key information about leasing arrangements. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early application of this ASU is permitted for all entities. Adoption of ASU 2016-02 is not expected to have a material impact on the Company's consolidated financial statements. The Company leases certain properties under operating leases that will result in the recognition of lease assets and lease liabilities on the Company's balance sheet under the ASU. At March 31, 2018, the Company had contractual future minimum lease commitments of approximately \$13.5 million, before considering renewal options that are generally present.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13"). Among other things, ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to form their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, ASU 2016-13 amends the accounting for credit losses on debt securities and purchased financial assets with credit deterioration. The amendments in ASU 2016-13 are effective for fiscal years beginning after December 31, 2019, and interim periods within those years for public business entities that are SEC filers. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2018, however, the Company does not currently plan to early adopt the ASU. We are evaluating the impact of the ASU on our consolidated financial statements. In addition to our allowance for loan losses, we will also record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized. The amount of the adjustments will be impacted by each portfolio's composition and credit quality at the adoption date as well as economic conditions and forecasts at that time.

**NOTE 2 – Investment Securities**

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

	Amortized Cost	March 31, 2018		Fair Value
		Gross Unrealized Gains	Losses	
(dollars in thousands)				
<b>Available for sale</b>				
US government agencies	\$ 7,743	1	214	7,530
SBA securities	3,925	-	100	3,825
State and political subdivisions	6,388	54	94	6,348
Mortgage-backed securities				
FHLMC	8,771	-	295	8,476
FNMA	27,798	2	702	27,098
GNMA	5,377	1	149	5,229
Total mortgage-backed securities	41,946	3	1,146	40,803
Total investment securities available for sale	\$60,002	58	1,554	58,506

10

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

(dollars in thousands)	Amortized Cost	December 31, 2017		Fair Value
		Gross Gains	Unrealized Losses	
<b>Available for sale</b>				
US government agencies	\$ 8,749	1	97	8,653
SBA securities	4,087	-	24	4,063
State and political subdivisions	11,242	179	25	11,396
Mortgage-backed securities				
FHLMC	9,102	-	149	8,953
FNMA	29,383	3	386	29,000
GNMA	5,618	2	82	5,538
Total mortgage-backed securities	44,103	5	617	43,491
Total	\$68,181	185	763	67,603

During the first three months of 2018, the Company sold \$5.8 million of investment securities, resulting in a loss on sale of \$1,000. During the first three months of 2017, there were no investment securities either sold or called.

Contractual maturities and yields on the Company's investment securities at March 31, 2018 and December 31, 2017 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)									March 31, 2018	
	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	\$ -	-	2,655	2.12%	4,875	2.48%	-	-	7,530	2.35%
SBA securities	-	-	-	-	-	-	3,825	2.53%	3,825	2.53%
State and political subdivisions	-	-	521	2.14%	4,523	3.11%	1,304	2.63%	6,348	2.93%
Mortgage-backed securities	282	0.52%	795	1.81%	11,587	1.87%	28,139	2.17%	40,803	2.06%
Total	\$ 282	0.52%	3,971	2.06%	20,985	2.28%	33,268	2.23%	58,506	2.22%

(dollars in thousands)									December 31, 2017	
	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	\$ 995	1.15%	1,503	2.04%	6,155	2.40%	-	-	8,653	2.20%
SBA securities	-	-	-	-	-	-	4,063	2.45%	4,063	2.45%
State and political subdivisions	-	-	1,163	1.96%	7,162	2.84%	3,071	2.76%	11,396	2.73%
Mortgage-backed securities	432	0.99%	-	-	11,328	1.84%	31,731	2.06%	43,491	1.99%
Total	\$ 1,427	1.10%	2,666	1.59%	24,645	2.27%	38,865	2.15%	67,603	2.17%

The tables below summarize gross unrealized losses on investment securities and the fair market value of the related securities at March 31, 2018 and December 31, 2017, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

(dollars in thousands)	Less than 12 months			12 months or longer			March 31, 2018		
	#	Fair Unrealized		#	Fair Unrealized		#	Total	
		value	losses		value	losses		Fair	Unrealized
<b>Available for sale</b>									
US government agencies	5	\$ 4,121	\$ 85	3	\$ 2,908	\$ 129	8	\$ 7,029	\$ 214
SBA securities	1	2,781	84	1	1,044	16	2	3,825	100
State and political subdivisions	6	2,618	57	2	769	37	8	3,387	94
Mortgage-backed securities									
FHLMC	3	2,740	75	7	5,736	220	10	8,476	295
FNMA	11	13,412	314	13	13,639	388	24	27,051	702
GNMA	3	4,393	92	1	816	57	4	5,209	149
Total	29	\$ 30,065	\$ 707	27	\$ 24,912	\$ 847	56	\$ 54,977	\$ 1,554

(dollars in thousands)	Less than 12 months			12 months or longer			December 31, 2017		
	#	Fair Unrealized		#	Fair Unrealized		#	Total	
		value	losses		value	losses		Fair	Unrealized
<b>Available for sale</b>									
US government agencies	5	\$ 4,184	\$ 22	4	\$ 3,968	\$ 75	9	\$ 8,152	\$ 97
SBA securities	1	2,936	13	1	1,127	11	2	4,063	24
State and political subdivisions	3	1,214	9	2	792	16	5	2,006	25
Mortgage-backed securities									
FHLMC	3	2,897	26	7	6,056	123	10	8,953	149
FNMA	11	14,345	135	13	14,597	251	24	28,942	386
GNMA	2	2,270	40	1	971	42	3	3,241	82
Total	25	\$ 27,846	\$ 245	28	\$ 27,511	\$ 518	53	\$ 55,357	\$ 763

At March 31, 2018, the Company had 29 individual investments with a fair market value of \$30.1 million that were in an unrealized loss position for less than 12 months and 27 individual investments with a fair market value of \$24.9 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. The Company also considers 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, the Company has concluded that these securities are not impaired on an other-than-temporary basis. Other investments are comprised of the following and are recorded at cost which approximates fair value.

(dollars in thousands)	March 31, 2018	December 31, 2017
Federal Home Loan Bank stock	\$ 2,524	3,754
Investment in Trust Preferred securities	403	403
Other investments	129	305
Total other investments	\$ 3,056	4,462

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 March 31, 2018 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 March 31, 2018 and December 31, 2017, \$4.1 million and \$7.7 million, respectively, of securities were pledged as collateral for repurchase agreements from brokers.

**NOTE 3 – Mortgage Loans Held for Sale**

Mortgage loans originated and intended for sale in the secondary market are reported as loans held for sale and carried at fair value under the fair value option with changes in fair value recognized in current period earnings. At the date of funding of the mortgage loan held for sale, the funded amount of the loan, the related derivative asset or liability of the associated interest rate lock commitment, less direct loan costs becomes the initial recorded investment in the loan held for sale. Such amount approximates the fair value of the loan. At March 31, 2018, mortgage loans held for sale totaled \$10.9 million compared to \$11.8 million at December 31, 2017.

Mortgage loans held for sale are considered de-recognized, or sold, when the Company surrenders control over the financial assets. Control is considered to have been surrendered when the transferred assets have been isolated from the Company, beyond the reach of the Company and its creditors; the purchaser obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and the Company does not maintain effective control over the transferred assets through an agreement that both entitles and obligates the Company to repurchase or redeem the transferred assets before their maturity or the ability to unilaterally cause the holder to return specific assets.

Gains and losses from the sale of mortgage loans are recognized based upon the difference between the sales proceeds and carrying value of the related loans upon sale and are recorded in mortgage banking income in the statement of income. Mortgage banking income also includes the unrealized gains and losses associated with the loans held for sale and the realized and unrealized gains and losses from derivatives.

Mortgage loans sold by the Company to investors and which were believed to have met investor and agency underwriting guidelines at the time of sale may be subject to repurchase or indemnification in the event of specific default by the borrower or subsequent discovery that underwriting standards were not met. The Company may, upon mutual agreement, agree to repurchase the loans or indemnify the investor against future losses on such loans. In such cases, the Company bears any subsequent credit loss on the loans.

The Company establishes mortgage repurchase reserves related to various representations and warranties that reflect management's estimate of losses based on a combination of factors. The Company establishes a reserve at the time loans are sold and quarterly updates the reserve estimate during the estimated loan life.

**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 \$2.5 million as of March 31, 2018 and \$2.3 million as of December 31, 2017.

(dollars in thousands)	March 31, 2018		December 31, 2017	
	Amount	% of Total	Amount	% of Total
<b>Commercial</b>				
Owner occupied RE	\$ 339,444	23.3%	\$ 316,818	22.8%
Non-owner occupied RE	339,231	23.2%	312,798	22.6%
Construction	56,210	3.8%	51,179	3.7%
Business	234,820	16.1%	226,158	16.3%
Total commercial loans	969,705	66.4%	906,953	65.4%
<b>Consumer</b>				
Real estate	275,731	18.9%	273,050	19.7%
Home equity	155,507	10.7%	156,141	11.3%
Construction	35,017	2.4%	28,351	2.0%
Other	23,422	1.6%	22,575	1.6%
Total consumer loans	489,677	33.6%	480,117	34.6%
Total gross loans, net of deferred fees	1,459,382	100.0%	1,387,070	100.0%
Less—allowance for loan losses	(15,852)		(15,523)	
Total loans, net	\$ 1,443,530		\$ 1,371,547	

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

*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.

	March 31, 2018			
	One year or less	After one but within five years	After five years	Total
(dollars in thousands)				
<b>Commercial</b>				
Owner occupied RE	\$ 23,682	177,441	138,321	339,444
Non-owner occupied RE	39,636	178,214	121,381	339,231
Construction	13,785	20,700	21,725	56,210
Business	67,252	119,869	47,699	234,820
Total commercial loans	144,355	496,224	329,126	969,705
<b>Consumer</b>				
Real estate	30,218	62,393	183,120	275,731
Home equity	11,775	27,386	116,346	155,507
Construction	19,720	868	14,429	35,017
Other	7,941	10,660	4,821	23,422
Total consumer loans	69,654	101,307	318,716	489,677
Total gross loans, net of deferred fees	\$ 214,009	597,531	647,842	1,459,382
Loans maturing after one year with:				
Fixed interest rates				\$ 942,192
Floating interest rates				303,181

	December 31, 2017			
	One year or less	After one but within five years	After five years	Total
(dollars in thousands)				
<b>Commercial</b>				
Owner occupied RE	\$ 24,171	167,425	125,222	316,818
Non-owner occupied RE	39,519	165,764	107,515	312,798
Construction	13,086	12,796	25,297	51,179
Business	73,588	107,584	44,986	226,158
Total commercial loans	150,364	453,569	303,020	906,953
<b>Consumer</b>				
Real estate	30,172	61,809	181,069	273,050
Home equity	13,331	25,807	117,003	156,141
Construction	14,943	1,737	11,671	28,351
Other	7,203	11,371	4,001	22,575
Total consumer	65,649	100,724	313,744	480,117
Total gross loan, net of deferred fees	\$ 216,013	554,293	616,764	1,387,070
Loans maturing after one year with :				
Fixed interest rates				\$ 875,991
Floating interest rates				295,066

**Portfolio Segment Methodology**

*Commercial*

Commercial loans are assessed for estimated losses by grading each loan using various risk factors identified through periodic reviews. The Company applies historic grade-specific loss factors to each loan class. In the development of statistically derived loan grade loss factors, the Company observes historical losses over 20 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, the Company determines the allowance on a collective basis utilizing historical losses over 20 quarters to represent its best estimate of inherent loss. The Company pools 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 its 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.

	March 31, 2018		Construction	Business	Total
	Owner occupied RE	Non-owner occupied RE			
(dollars in thousands)					
Pass	\$ 335,912	335,321	56,210	227,672	955,115
Special mention	540	53	-	3,878	4,471
Substandard	2,992	3,857	-	3,270	10,119
Doubtful	-	-	-	-	-
	\$ 339,444	339,231	56,210	234,820	969,705

15

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

	December 31, 2017				
	Owner	Non-owner			
(dollars in thousands)					
	<b>occupied RE</b>	<b>occupied RE</b>	<b>Construction</b>	<b>Business</b>	<b>Total</b>
Pass	\$ 312,628	306,965	51,179	215,729	886,501
Special mention	1,770	2,082	-	5,540	9,392
Substandard	2,420	3,751	-	4,889	11,060
Doubtful	-	-	-	-	-
	\$ 316,818	312,798	51,179	226,158	906,953

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

	March 31, 2018				
	Owner	Non-owner			
(dollars in thousands)					
	<b>occupied RE</b>	<b>occupied RE</b>	<b>Construction</b>	<b>Business</b>	<b>Total</b>
Current	\$ 338,915	339,038	56,210	234,386	968,549
30-59 days past due	529	-	-	332	861
60-89 days past due	-	-	-	-	-
Greater than 90 Days	-	193	-	102	295
	\$ 339,444	339,231	56,210	234,820	969,705

	December 31, 2017				
	Owner	Non-owner			
(dollars in thousands)					
	<b>occupied RE</b>	<b>occupied RE</b>	<b>Construction</b>	<b>Business</b>	<b>Total</b>
Current	\$ 316,818	312,477	51,179	224,861	905,335
30-59 days past due	-	129	-	416	545
60-89 days past due	-	-	-	-	-
Greater than 90 Days	-	192	-	881	1,073
	\$ 316,818	312,798	51,179	226,158	906,953

As of March 31, 2018 and December 31, 2017, loans 30 days or more past due represented 0.30% and 0.34% of the Company's total loan portfolio, respectively. Commercial loans 30 days or more past due were 0.08% and 0.12% of the Company's total loan portfolio as of March 31, 2018 and December 31, 2017, respectively.

*Consumer*

The Company manages a consistent process for assessing consumer loan credit quality by monitoring its loan grading trends and past due statistics. All loans are subject to individual risk assessment. The Company's 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 the allowance for loan losses.

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

	March 31, 2018				
	Real estate	Home equity	Construction	Other	Total
(dollars in thousands)					
Pass	\$ 271,915	151,586	35,017	23,172	481,690
Special mention	440	619	-	184	1,243
Substandard	3,376	3,302	-	66	6,744
Doubtful	-	-	-	-	-
	\$ 275,731	155,507	35,017	23,422	489,677

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

	December 31, 2017				
(dollars in thousands)	Real estate	Home equity	Construction	Other	Total
Pass	\$ 269,422	152,545	28,351	22,367	472,685
Special mention	715	1,025	-	88	1,828
Substandard	2,913	2,571	-	120	5,604
Doubtful	-	-	-	-	-
	\$ 273,050	156,141	28,351	22,575	480,117

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

	March 31, 2018				
(dollars in thousands)	Real estate	Home equity	Construction	Other	Total
Current	\$ 274,302	153,827	35,017	23,317	486,463
30-59 days past due	1,304	829	-	105	2,238
60-89 days past due	125	-	-	-	125
Greater than 90 Days	-	851	-	-	851
	\$ 275,731	155,507	35,017	23,422	489,677

	December 31, 2017				
(dollars in thousands)	Real estate	Home equity	Construction	Other	Total
Current	\$ 271,284	154,821	28,351	22,506	476,962
30-59 days past due	681	325	-	69	1,075
60-89 days past due	131	995	-	-	1,126
Greater than 90 Days	954	-	-	-	954
	\$ 273,050	156,141	28,351	22,575	480,117

As of March 31, 2018 and December 31, 2017, consumer loans 30 days or more past due were 0.22% and 0.23% of total loans, respectively.

### 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 the Company believes, 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.

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

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

(dollars in thousands)	March 31, 2018	December 31, 2017
<b>Commercial</b>		
Owner occupied RE	\$ -	-
Non-owner occupied RE	1,525	1,581
Construction	-	-
Business	102	910
<b>Consumer</b>		
Real estate	1,091	992
Home equity	1,730	1,144
Construction	-	-
Other	-	1
Nonaccruing troubled debt restructurings	2,826	2,673
Total nonaccrual loans, including nonaccruing TDRs	7,274	7,301
Other real estate owned	242	242
Total nonperforming assets	\$ 7,516	7,543
Nonperforming assets as a percentage of:		
Total assets	0.43%	0.46%
Gross loans	0.52%	0.54%
Total loans over 90 days past due	1,146	2,027
Loans over 90 days past due and still accruing	-	-
Accruing troubled debt restructurings	\$ 5,648	5,145

**Impaired Loans**

The table below summarizes key information for impaired loans. The Company's 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. The Company's commercial and consumer impaired loans are evaluated individually to determine the related allowance for loan losses.

(dollars in thousands)	March 31, 2018			
	Recorded investment			
	Unpaid Principal Balance	Impaired loans	Impaired loans with related allowance for loan losses	Related allowance for loan losses
<b>Commercial</b>				
Owner occupied RE	\$ 2,276	2,227	1,798	180
Non-owner occupied RE	6,893	3,717	2,119	729
Construction	-	-	-	-
Business	2,580	1,863	1,863	943
Total commercial	11,749	7,807	5,780	1,852
<b>Consumer</b>				
Real estate	2,846	2,795	2,128	1,285
Home equity	2,751	2,154	1,275	566
Construction	-	-	-	-
Other	166	166	166	20
Total consumer	5,763	5,115	3,569	1,871
Total	\$ 17,512	12,922	9,349	3,723

	December 31, 2017			
	Recorded investment			Related allowance for loan losses
	Unpaid Principal Balance	Impaired loans	Impaired loans with related allowance for loan losses	
(dollars in thousands)				
<b>Commercial</b>				
Owner occupied RE	\$ 2,281	2,235	464	179
Non-owner occupied RE	6,827	3,665	2,646	750
Construction	-	-	-	-
Business	3,735	2,764	1,993	1,061
Total commercial	12,843	8,664	5,103	1,990
<b>Consumer</b>				
Real estate	2,062	2,037	2,037	1,379
Home equity	2,010	1,575	680	286
Construction	-	-	-	-
Other	171	170	170	22
Total consumer	4,243	3,782	2,887	1,687
Total	\$ 17,086	12,446	7,990	3,677

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 March 31, 2018		Three months ended March 31, 2017		Year ended December 31, 2017	
	Average recorded investment	Recognized interest income	Average recorded investment	Recognized interest income	Average recorded investment	Recognized interest income
	(dollars in thousands)					
<b>Commercial</b>						
Owner occupied RE	\$ 2,231	17	2,232	28	2,255	104
Non-owner occupied RE	3,758	50	3,927	29	4,144	199
Construction	-	-	-	-	-	-
Business	1,886	21	3,675	40	2,823	162
Total commercial	7,875	88	9,834	97	9,222	465
<b>Consumer</b>						
Real estate	2,814	41	1,836	16	2,047	69
Home equity	2,203	28	256	1	1,576	97
Construction	-	-	-	-	-	-
Other	168	1	182	-	174	6
Total consumer	5,185	70	2,274	17	3,797	172
Total	\$ 13,060	158	12,108	114	13,019	637

#### 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.

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

The Company has an established process to determine the adequacy of the allowance for loan losses that assesses the losses inherent in the portfolio. While the Company attributes portions of the allowance to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. The Company's process involves procedures to appropriately consider the unique risk characteristics of the commercial and consumer loan portfolio segments. For each portfolio segment, impairment is measured individually for each impaired loan. The Company's 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 the allowance for loan losses by commercial and consumer portfolio segments:

	Commercial							Three months ended March 31, 2018		Consumer	Total
	Owner	Non-owner	Construction	Business	Real Estate	Home equity	Construction	Other			
	occupied RE	occupied RE									
(dollars in thousands)											
<b>Balance, beginning of period</b>	\$ 2,534	3,230	325	3,848	3,495	1,600	210	281		15,523	
Provision for loan losses	146	135	90	(294)	(105)	451	46	31		500	
Loan charge-offs	-	-	-	(119)	-	(140)	-	(34)		(293)	
Loan recoveries	-	1	-	118	1	-	-	2		122	
Net loan charge-offs	-	1	-	(1)	1	(140)	-	(32)		(171)	
<b>Balance, end of period</b>	\$ 2,680	3,366	415	3,553	3,391	1,911	256	280		15,852	
Net charge-offs to average loans (annualized)										0.05%	
Allowance for loan losses to gross loans										1.09%	
Allowance for loan losses to nonperforming loans										217.92%	

	Commercial							Three months ended March 31, 2017		Consumer	Total
	Owner	Non-owner	Construction	Business	Real Estate	Home equity	Construction	Other			
	occupied RE	occupied RE									
(dollars in thousands)											
<b>Balance, beginning of period</b>	\$ 2,843	2,778	295	4,123	2,780	1,475	252	309		14,855	
Provision for loan losses	209	369	39	(321)	(40)	143	37	64		500	
Loan charge-offs	-	(181)	-	(9)	-	-	-	-		(190)	
Loan recoveries	-	1	-	30	90	1	-	-		122	
Net loan charge-offs	-	(180)	-	21	90	1	-	-		(68)	
<b>Balance, end of period</b>	\$ 3,052	2,967	334	3,823	2,830	1,619	289	373		15,287	
Net charge-offs to average loans (annualized)										0.02%	
Allowance for loan losses to gross loans										1.25%	
Allowance for loan losses to nonperforming loans										247.43%	

The following table disaggregates the allowance for loan losses and recorded investment in loans by impairment methodology.

	Allowance for loan losses			Recorded investment in loans		
	Commercial	Consumer	Total	Commercial	Consumer	Total
	(dollars in thousands)					
Individually evaluated	\$ 1,852	1,871	3,723	7,807	5,115	12,922
Collectively evaluated	8,162	3,967	12,129	961,898	484,562	1,446,460
<b>Total</b>	\$ 10,014	5,838	15,852	969,705	489,677	1,459,382

	Allowance for loan losses			Recorded investment in loans		
	Commercial	Consumer	Total	Commercial	Consumer	Total
	(dollars in thousands)					
Individually evaluated	\$ 1,990	1,687	3,677	8,664	3,782	12,446
Collectively evaluated	7,947	3,899	11,846	898,289	476,335	1,374,624
<b>Total</b>	\$ 9,937	5,586	15,523	906,953	480,117	1,387,070

**NOTE 5 – Troubled Debt Restructurings**

At March 31, 2018, the Company had 22 loans totaling \$8.5 million which were considered as TDRs compared to 21 loans totaling \$7.8 million at December 31, 2017 which were considered as TDRs. The Company considers a loan to be a TDR when the debtor experiences financial difficulties and the Company grants a concession to the debtor that it would not normally consider. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of the workout plan for individual loan relationships, the Company may restructure loan terms to assist borrowers facing financial challenges in the current economic environment. To date, the Company has restored three commercial loans previously classified as TDRs to accrual status.

The following table summarizes the concession at the time of modification and the recorded investment in the Company's TDRs before and after their modification.

	For the three months ended March 31, 2018						
	Renewals deemed a concession	Reduced or deferred payments	Converted to interest only	Maturity date extensions	Total Number of loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
(dollars in thousands)							
<b>Consumer</b>							
Real estate	2	-	-	-	2	\$ 549	\$ 669
Total loans	2	-	-	-	2	\$ 549	\$ 669

	For the three months ended March 31, 2017						
	Renewals deemed a concession	Reduced or deferred payments	Converted to interest only	Maturity date extensions	Total Number of loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
(dollars in thousands)							
<b>Commercial</b>							
Business	1	-	-	-	1	\$ 149	\$ 149
Total loans	1	-	-	-	1	\$ 149	\$ 149

As of March 31, 2018, there were no loans modified as a TDR for which there was a payment default (60 days past due) within 12 months of the restructuring date. There was one such loan as of March 31, 2017 with a recorded investment of \$187,000.

**NOTE 6 – Derivative Financial Instruments**

The Company utilizes derivative financial instruments primarily to hedge its exposure to changes in interest rates. All derivative financial instruments are recognized as either assets or liabilities and measured at fair value. The Company accounts for all of its derivatives as free-standing derivatives and does not designate any of these instruments for hedge accounting. Therefore, the gain or loss resulting from the change in the fair value of the derivative is recognized in the Company's statement of income during the period of change.

The Company enters into commitments to originate residential mortgage loans held for sale, at specified interest rates and within a specified period of time, with clients who have applied for a loan and meet certain credit and underwriting criteria (interest rate lock commitments). These interest rate lock commitments ("IRLCs") meet the definition of a derivative financial instrument and are reflected in the balance sheet at fair value with changes in fair value recognized in current period earnings. Unrealized gains and losses on the IRLCs are recorded as derivative assets and derivative liabilities, respectively, and are measured based on the value of the underlying mortgage loan, quoted mortgage-backed securities ("MBS") prices and an estimate of the probability that the mortgage loan will fund within the terms of the interest rate lock commitment, net of estimated commission expenses.

The Company manages the interest rate and price risk associated with its outstanding IRLCs and mortgage loans held for sale by entering into derivative instruments such as forward sales of MBS. Management expects these derivatives will experience changes in fair value opposite to changes in fair value of the IRLCs and mortgage loans held for sale, thereby reducing earnings volatility. The Company takes into account various factors and strategies in determining the portion of the mortgage pipeline (IRLCs and mortgage loans held for sale) it wants to economically hedge.

## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

The following table summarizes the Company's outstanding financial derivative instruments at March 31, 2018 and December 31, 2017.

(dollars in thousands)	<b>Notional</b>	<b>Balance Sheet Location</b>	<b>March 31, 2018 Fair Value Asset/(Liability)</b>
Mortgage loan interest rate lock commitments	\$ 25,139	Other assets	\$ 384
MBS forward sales commitments	19,000	Other liabilities	(88)
Total derivative financial instruments	\$ 44,139		\$ 296

  

(dollars in thousands)	<b>Notional</b>	<b>Balance Sheet Location</b>	<b>December 31, 2017 Fair Value Asset/(Liability)</b>
Mortgage loan interest rate lock commitments	\$ 15,430	Other assets	\$ 196
MBS forward sales commitments	10,750	Other liabilities	(28)
Total derivative financial instruments	\$ 26,180		\$ 168

### **NOTE 7 – Fair Value Accounting**

FASB ASC 820, "Fair Value Measurement and Disclosures," defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

#### **Level 1 – Quoted market price in active markets**

Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include certain debt and equity securities that are traded in an active exchange market.

#### **Level 2 – Significant other observable inputs**

Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include fixed income securities and mortgage-backed securities that are held in the Company's available-for-sale portfolio and valued by a third-party pricing service, as well as certain impaired loans.

#### **Level 3 – Significant unobservable inputs**

Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. These methodologies may result in a significant portion of the fair value being derived from unobservable data.

The methods of determining the fair value of assets and liabilities presented in this note are consistent with our methodologies disclosed in Note 13 of the Company's 2017 Form 10-K, except for the valuation of loans held for investment which was impacted by the adoption of ASU 2016-01. Prior to adopting the amendments included in the standard, the Company was allowed to measure fair value under an entry price notion. The entry price notion previously applied by the Company used a discounted cash flows technique to calculate the present value of expected future cash flows for a financial instrument. The exit price notion uses the same approach, but also incorporates other factors, such as enhanced credit risk, illiquidity risk and market factors that sometimes exist in exit prices in dislocated markets. As of March 31, 2018, the technique used by the Company to estimate the exit price of the loan portfolio consists of similar procedures to those used as of December 31, 2017, but with added emphasis on both illiquidity risk and credit risk not captured by the previously applied entry price notion. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. The Company's loan portfolio is initially fair valued using a segmented approach, using the eight categories as disclosed in Note 4 – Loans and Allowance for Loan Losses. Loans are considered a Level 3 classification.

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

*Assets and Liabilities Recorded at Fair Value on a Recurring Basis*

The tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis as of March 31, 2018 and December 31, 2017.

(dollars in thousands)	March 31, 2018			
	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Securities available for sale				
US government agencies	\$ -	7,530	-	7,530
SBA securities	-	3,825	-	3,825
State and political subdivisions	-	6,348	-	6,348
Mortgage-backed securities	-	40,803	-	40,803
Mortgage loans held for sale	-	10,885	-	10,885
Mortgage loan interest rate lock commitments	-	384	-	384
Total assets measured at fair value on a recurring basis	\$ -	69,775	-	69,775
<b>Liabilities</b>				
MBS forward sales commitments	\$ -	88	-	88
Total liabilities measured at fair value on a recurring basis	\$ -	88	-	88

(dollars in thousands)	December 31, 2017			
	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Securities available for sale:				
US government agencies	\$ -	8,653	-	8,653
SBA securities	-	4,063	-	4,063
State and political subdivisions	-	11,396	-	11,396
Mortgage-backed securities	-	43,491	-	43,491
Mortgage loans held for sale	-	11,790	-	11,790
Mortgage loan interest rate lock commitments	-	196	-	196
Total assets measured at fair value on a recurring basis	\$ -	79,589	-	79,589
<b>Liabilities</b>				
MBS forward sales commitments	\$ -	28	-	28
Total liabilities measured at fair value on a recurring basis	\$ -	28	-	28

*Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis*

The tables below present the recorded amount of assets and liabilities measured at fair value on a nonrecurring basis as of March 31, 2018 and December 31, 2017.

(dollars in thousands)	As of March 31, 2018			
	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Impaired loans	\$ -	2,083	7,116	9,199
Other real estate owned	-	148	94	242
Total assets measured at fair value on a nonrecurring basis	\$ -	2,231	7,210	9,441

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

(dollars in thousands)	As of December 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets				
Impaired loans	\$ -	2,685	6,084	8,769
Other real estate owned	-	148	94	242
Total assets measured at fair value on a nonrecurring basis	\$ -	2,833	6,178	9,011

The Company had no liabilities carried at fair value or measured at fair value on a nonrecurring basis.

*Impaired Loans*

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan may be considered impaired and an allowance for loan losses may be established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures the impairment in accordance with FASB ASC 310, "Receivables." The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. In accordance with FASB ASC 820, "Fair Value Measurement and Disclosures," impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company considers the impaired loan as nonrecurring Level 2. The Company's current loan and appraisal policies require the Company to obtain updated appraisals on an "as is" basis at renewal, or in the case of an impaired loan, on an annual basis, either through a new external appraisal or an appraisal evaluation. The Company reviews the third party appraisal for appropriateness and adjusts the value downward to consider selling and closing costs, which typically range from 7% - 10% of the appraised value. For non-real estate loans, fair value of the of the impaired loan's collateral may be determined using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the impaired loan as nonrecurring Level 3. The fair value of impaired loans may also be estimated using the present value of expected future cash flows to be realized on the loan, which is also considered a Level 3 valuation. These fair value estimates are subject to fluctuations in assumptions about the amount and timing of expected cash flows as well as the choice of discount rate used in the present value calculation.

*Other Real Estate Owned ("OREO")*

OREO, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at the lower of cost or fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs (Level 2). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. Gains or losses on sale and generally any subsequent adjustments to the value are recorded as a component of real estate owned activity. The unobservable inputs may vary depending on the individual assets and valuation approach. The Company reviews the third party appraisal for appropriateness and adjusts the value downward to consider selling and closing costs, which typically range from 7% to 10% of the appraised value. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the OREO as nonrecurring Level 3.

*Fair Value of Financial Instruments*

Financial instruments require disclosure of fair value information, whether or not recognized in the consolidated balance sheets, when it is practical to estimate the fair value. A financial instrument is defined as cash, evidence of an ownership interest in an entity or a contractual obligation which requires the exchange of cash. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock, premises and equipment and other assets and liabilities.

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

The estimated fair values of the Company's financial instruments at March 31, 2018 and December 31, 2017 are as follows:

	March 31, 2018		Fair	Level 1	Level 2	Level 3
	Carrying	Value				
(dollars in thousands)	Amount	Value				
<b>Financial Assets:</b>						
Other investments, at cost	\$ 3,056	3,056	-	-	-	3,056
Loans <sup>1</sup>	1,446,460	1,431,556	-	-	-	1,431,556
<b>Financial Liabilities:</b>						
Deposits	1,520,523	1,388,405	-	1,388,405	-	-
FHLB and other borrowings	28,600	28,839	-	28,839	-	-
Junior subordinated debentures	13,403	14,029	-	14,029	-	-
<b>December 31, 2017</b>						
	Carrying	Fair	Level 1	Level 2	Level 3	
(dollars in thousands)	Amount	Value				
<b>Financial Assets:</b>						
Other investments, at cost	\$ 4,462	4,462	-	-	-	4,462
Loans <sup>1</sup>	1,374,624	1,375,761	-	-	-	1,375,761
<b>Financial Liabilities:</b>						
Deposits	1,381,123	1,269,462	-	1,269,462	-	-
FHLB and other borrowings	67,200	67,890	-	67,890	-	-
Junior subordinated debentures	13,403	13,166	-	13,166	-	-

Carrying amount is net of the allowance for loan losses and previously presented impaired loans. In accordance with the prospective adoption of ASU No. 2016-01, the fair value of loans as of March 31, 2018 was measured using an exit price notion.

The fair value of loans as of December 31, 2017 was measured using an entry price notion.

**NOTE 8 – Earnings Per Common Share**

The following schedule reconciles the numerators and denominators of the basic and diluted earnings per share computations for the three month periods ended March 31, 2018 and 2017. Dilutive common shares arise from the potentially dilutive effect of the Company's stock options that were outstanding at March 31, 2018. The assumed conversion of stock options can create a difference between basic and dilutive net income per common share. At March 31, 2018 and 2017, there were 166,172 and 94,070 options, respectively, that were not considered in computing diluted earnings per common share because they were anti-dilutive.

	Three months ended	
	March 31, 2018	2017
(dollars in thousands, except share data)		
Numerator:		
Net income available to common shareholders	\$ 5,214	3,112
Denominator:		
Weighted-average common shares outstanding – basic	7,336,839	6,437,231
Common stock equivalents	390,046	392,359
Weighted-average common shares outstanding – diluted	7,726,885	6,829,590
Earnings per common share:		
Basic	\$ 0.71	0.48
Diluted	\$ 0.67	0.46

**NOTE 9 – Reportable Segments**

The Company's reportable segments represent the distinct product lines the Company offers and are viewed separately for strategic planning purposes by management. The three segments include Commercial and Retail Banking, Mortgage Banking, and Corporate. The following schedule presents financial information for each reportable segment.

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

(dollars in thousands)	Three months ended					Three months ended				
	March 31, 2018		March 31, 2017			March 31, 2017		March 31, 2017		
	Commercial and Retail Mortgage		Commercial			Commercial		Commercial		
	Banking	Banking	Corporate	Elimination	Consolidated	Banking	Banking	Corporate	Elimination	Consolidated
Interest income	\$ 17,078	100	2	(2)	17,178	13,893	66	2	(2)	13,959
Interest expense	3,019	-	119	(2)	3,136	2,223	-	131	(2)	2,352
Net interest income (loss)	14,059	100	(117)	-	14,042	11,670	66	(129)	-	11,607
Provision for loan losses	500	-	-	-	500	500	-	-	-	500
Noninterest income	1,092	1,328	-	-	2,420	994	1,057	-	-	2,051
Noninterest expense	8,181	964	60	-	9,205	7,446	848	66	-	8,360
Net income (loss) before taxes	6,470	464	(177)	-	6,757	44,718	275	(195)	-	4,798
Income tax provision (benefit)	1,483	97	(37)	-	1,543	1,653	102	(69)	-	1,686
Net income (loss)	\$ 4,987	367	(140)	-	5,214	3,065	173	(126)	-	3,112
Total assets	\$ 1,720,017	8,814	168,137	(167,669)	1,729,299	1,459,695	7,808	136,996	(136,561)	1,467,938

**Commercial and retail banking.** The Company's primary business is to provide traditional deposit and lending products and services to its commercial and retail banking clients.

**Mortgage banking.** The mortgage banking segment provides mortgage loan origination services for loans that will be sold in the secondary market to investors.

**Corporate.** Corporate is comprised primarily of compensation and benefits for certain members of management and interest on parent company debt.

## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion reviews our results of operations for the three month period ended March 31, 2018 as compared to the three month period ended March 31, 2017 and assesses our financial condition as of March 31, 2018 as compared to December 31, 2017. You should read the following discussion and analysis in conjunction with the accompanying consolidated financial statements and the related notes and the consolidated financial statements and the related notes for the year ended December 31, 2017 included in our Annual Report on Form 10-K for that period. Results for the three month period ended March 31, 2018 are not necessarily indicative of the results for the year ending December 31, 2018 or any future period.

### Cautionary Warning Regarding Forward-Looking Statements

This report, including information included or incorporated by reference in this report, contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may relate to our financial condition, results of operations, plans, objectives, or future performance. These statements are based on many assumptions and estimates and are not guarantees of future performance. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. The words "may," "would," "could," "should," "will," "expect," "anticipate," "predict," "project," "potential," "believe," "continue," "assume," "intend," "plan," and "estimate," as well as expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties that could cause our actual results to differ from those anticipated in any forward-looking statements include, but are not limited to, those described under Item 1A-Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2017, as well as the following:

Restrictions or conditions imposed by our regulators on our operations;

Increases in competitive pressure in the banking and financial services industries;

Changes in access to funding or increased regulatory requirements with regard to funding;

Changes in deposit flows;

Credit losses as a result of declining real estate values, increasing interest rates, increasing unemployment, changes in payment behavior or other factors;

26

---

## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

Credit losses due to loan concentration;

Changes in the amount of our loan portfolio collateralized by real estate and weaknesses in the real estate market;

Our ability to successfully execute our business strategy;

Our ability to attract and retain key personnel;

The success and costs of our expansion into the Greensboro, North Carolina, Raleigh, North Carolina and Atlanta, Georgia markets;

Changes in the interest rate environment which could reduce anticipated or actual margins;

Changes in political conditions or the legislative or regulatory environment, including governmental initiatives affecting the financial services industry;

Changes in economic conditions resulting in, among other things, a deterioration in credit quality;

Changes occurring in business conditions and inflation;

Increased cybersecurity risk, including potential business disruptions or financial losses;

Changes in technology;

The adequacy of the level of our allowance for loan losses and the amount of loan loss provisions required in future periods;

Examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, require us to increase our allowance for loan losses or write-down assets;

Changes in monetary and tax policies;

The rate of delinquencies and amounts of loans charged-off;

The rate of loan growth in recent years and the lack of seasoning of a portion of our loan portfolio;

Our ability to maintain appropriate levels of capital and to comply with our capital ratio requirements;

Adverse changes in asset quality and resulting credit risk-related losses and expenses;

Changes in accounting policies and practices; and

Other risks and uncertainties detailed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017, in Part II, Item 1A of this Quarterly Report on Form 10-Q, and from time to time in our other filings with the Securities and Exchange Commission (the "SEC").

If any of these risks or uncertainties materialize, or if any of the assumptions underlying such forward-looking statements proves to be incorrect, our results could differ materially from those expressed in, implied or projected by, such forward-looking statements. For information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see "Risk Factors" under Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017 and "Risk Factors" under Part II, Item 1A of this Quarterly Report on Form 10-Q. We urge investors to consider all of these factors carefully in evaluating the forward-looking statements contained in this Quarterly Report on Form 10-Q. We make these forward-looking statements as of the date of this document and we do not intend, and assume no obligation, to update the forward-looking statements or to update the reasons why actual results could differ from those expressed in, or implied or projected by, the forward-looking statements.

**OVERVIEW**

Our business model continues to be client-focused, utilizing relationship teams to provide our clients with a specific banker contact and support team responsible for all of their banking needs. The purpose of this structure is to provide a consistent and superior level of professional service, and we believe it provides us with a distinct competitive advantage. We consider exceptional client service to be a critical part of our culture, which we refer to as "ClientFIRST."

27

---

## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

At March 31, 2018, we had total assets of \$1.7 billion, a 6.4% increase from total assets of \$1.6 billion at December 31, 2017. The largest components of our total assets are loans, cash and cash equivalents and securities which were \$1.5 billion, \$136.1 million and \$61.6 million, respectively, at March 31, 2018. Comparatively, our loans, cash and cash equivalents and securities totaled \$1.4 billion, \$92.2 million and \$72.1 million, respectively, at December 31, 2017. Our liabilities and shareholders' equity at March 31, 2018 totaled \$1.6 billion and \$154.7 million, respectively, compared to liabilities of \$1.5 billion and shareholders' equity of \$149.7 million at December 31, 2017. The principal component of our liabilities is deposits which were \$1.5 billion and \$1.4 billion at March 31, 2018 and December 31, 2017, respectively.

Like most community banks, we derive the majority of our income from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowings. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread. In addition to earning interest on our loans and investments, we earn income through fees and other charges to our clients.

Our net income to common shareholders was \$5.2 million and \$3.1 million for the three months ended March 31, 2018 and 2017, respectively, an increase of \$2.1 million, or 67.5%. Diluted earnings per share ("EPS") was \$0.67 for the first quarter of 2018 as compared to \$0.46 for the same period in 2017. The increase in net income resulted primarily from increases in net interest income and noninterest income and partially offset due to an increase in noninterest expense. In addition, as a result of the Tax Act which was passed in December 2017, our effective tax rate declined from 35.1% for the first quarter of 2017 to 22.8% for the first quarter of 2018.

Economic conditions, competition, and the monetary and fiscal policies of the Federal government significantly affect most financial institutions, including the Bank. Lending and deposit activities and fee income generation are influenced by levels of business spending and investment, consumer income, consumer spending and savings, capital market activities, and competition among financial institutions, as well as customer preferences, interest rate conditions and prevailing market rates on competing products in our market areas.

### RESULTS OF OPERATIONS

#### *Net Interest Income and Margin*

Our level of net interest income is determined by the level of earning assets and the management of our net interest margin. Our net interest income was \$14.0 million for the three month period ended March 31, 2018, a 21.0% increase over net interest income of \$11.6 million for the same period in 2017. In comparison, our average earning assets increased 19.7%, or \$259.0 million, during the first quarter of 2018 compared to the first quarter of 2017, while our interest-bearing liabilities increased by \$182.2 million, or 17.9%, during the same period. The increase in average earning assets is primarily related to an increase in average loans and average federal funds sold, while the increase in average interest-bearing liabilities is primarily a result of an increase in interest-bearing deposits, partially offset by a decrease in FHLB advances and other borrowings.

We have included a number of tables to assist in our description of various measures of our financial performance. For example, the "Average Balances, Income and Expenses, Yields and Rates" table reflects the average balance of each category of our assets and liabilities as well as the yield we earned or the rate we paid with respect to each category during the three month periods ended March 31, 2018 and 2017. A review of this table shows that our loans typically provide higher interest yields than do other types of interest-earning assets, which is why we direct a substantial percentage of our earning assets into our loan portfolio. Similarly, the "Rate/Volume Analysis" table demonstrates the effect of changing interest rates and changing volume of assets and liabilities on our financial condition during the periods shown. We also track the sensitivity of our various categories of assets and liabilities to changes in interest rates, and we have included tables to illustrate our interest rate sensitivity with respect to interest-earning accounts and interest-bearing accounts.

The following tables set forth information related to our average balance sheets, average yields on assets, and average costs of liabilities. We derived these yields by dividing income or expense by the average balance of the corresponding assets or liabilities. We derived average balances from the daily balances throughout the periods indicated. During the same periods, we had no securities purchased with agreements to resell. All investments owned have an original maturity of over one year. Nonaccrual loans are included in the following tables. Loan yields have been reduced to reflect the negative impact on our earnings of loans on nonaccrual status. The net of capitalized loan costs and fees are amortized into interest income on loans.

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

Average Balances, Income and Expenses, Yields and Rates

(dollars in thousands)	For the Three Months Ended March 31,			2017		
	2018					
	Average Balance	Income/ Expense	Yield/ Rate <sup>(1)</sup>	Average Balance	Income/ Expense	Yield/ Rate <sup>(1)</sup>
<b>Interest-earning assets</b>						
Federal funds sold	\$ 61,743	\$ 247	1.62%	\$ 29,514	\$ 57	0.78%
Investment securities, taxable	58,029	312	2.18%	50,168	255	2.06%
Investment securities, nontaxable <sup>(2)</sup>	7,046	73	4.19%	19,614	195	4.04%
Loans <sup>(3)</sup>	1,444,343	16,563	4.65%	1,212,820	13,526	4.52%
Total interest-earning assets	1,571,161	17,195	4.44%	1,312,116	14,033	4.34%
Noninterest-earning assets	74,685			65,246		
Total assets	\$ 1,645,846			\$ 1,377,362		
<b>Interest-bearing liabilities</b>						
NOW accounts	\$ 238,690	91	0.15%	\$ 219,743	98	0.18%
Savings & money market	595,374	1,577	1.07%	387,213	552	0.58%
Time deposits	315,344	1,070	1.38%	272,214	599	0.89%
Total interest-bearing deposits	1,149,408	2,738	0.97%	879,170	1,249	0.58%
FHLB advances and other borrowings	35,287	283	3.25%	123,345	999	3.28%
Junior subordinated debentures	13,403	115	3.48%	13,403	104	3.15%
Total interest-bearing liabilities	1,198,098	3,136	1.06%	1,015,918	2,352	0.94%
Noninterest-bearing liabilities	295,374			249,478		
Shareholders' equity	152,374			111,966		
Total liabilities and shareholders' equity	\$ 1,645,846			\$ 1,377,362		
Net interest spread			3.38%			3.40%
Net interest income (tax equivalent) / margin		\$ 14,059	3.63%		\$ 11,681	3.61%
Less: tax-equivalent adjustment <sup>(2)</sup>		17			74	
Net interest income		\$ 14,042			\$ 11,607	

(1) Annualized for the three month period.

The tax-equivalent adjustment to net interest income adjusts the yield for assets earning tax-exempt income to a comparable (2) yield on a taxable basis.

(3) Includes mortgage loans held for sale.

Our net interest margin, on a tax-equivalent basis, was 3.63% for the three months ended March 31, 2018 compared to 3.61% for the first quarter of 2017. The two basis point increase in net interest margin was driven by the increase in yield on our interest-earning assets partially offset by the increased rate on our interest-bearing liabilities compared to the prior year. Our average interest-earning assets grew by \$259.0 million during the first three months of 2018 as compared to the same period in 2017, while the average yield on these assets increased by 10 basis points. In addition, our average interest-bearing liabilities grew by \$182.2 million during the 2018 period while the rate on these liabilities increased 12 basis points to 1.06% for the three months ended March 31, 2018.

The \$259.0 million increase in average interest-earning assets for the three months ended March 31, 2018 as compared to the same quarter in 2017, primarily related to a \$231.5 million increase in our average loan balances and a \$32.2 million increase in average federal funds sold during the 2018 period. The 10 basis point increase in yield on these assets was driven by a 13 basis point increase in our loan yield. The higher yield on our loan portfolio was due to loans being originated or renewed at market rates which are higher than those in the past.

In addition, our average interest-bearing liabilities increased by \$182.2 million during the first quarter of 2018 as compared to the first quarter of 2017, while the cost of our interest-bearing liabilities increased by 12 basis points during the same period. The increased rate during the 2018 period resulted primarily from a \$270.2 million increase in our interest-bearing deposits at an average rate of 0.97% which is 39 basis points higher than the average rate in the first quarter of 2017.

## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

Our net interest spread was 3.38% for the three months ended March 31, 2018 compared to 3.40% for the same period in 2017. The net interest spread is the difference between the yield we earn on our interest-earning assets and the rate we pay on our interest-bearing liabilities. The 10 basis point increase in yield on our interest-earning assets and the 12 basis point increase in rate on our interest-bearing liabilities, resulted in a two basis point decrease in our net interest spread for the 2018 period. We anticipate continued pressure on our net interest spread and net interest margin in future periods based on the possibility of additional Federal Reserve interest rate increases and a competitive rate environment.

### *Rate/Volume Analysis*

Net interest income can be analyzed in terms of the impact of changing interest rates and changing volume. The following table sets forth the effect which the varying levels of interest-earning assets and interest-bearing liabilities and the applicable rates have had on changes in net interest income for the periods presented.

(dollars in thousands)	<b>Three Months Ended March 31, 2018 vs. 2017 Increase (Decrease) Due to</b>				<b>March 31, 2017 vs. 2016 Increase (Decrease) Due to</b>				
			<b>Rate/</b>				<b>Rate/</b>		
	<b>Volume</b>	<b>Rate</b>	<b>Volume</b>	<b>Total</b>	<b>Volume</b>	<b>Rate</b>	<b>Volume</b>	<b>Total</b>	
Interest income									
Loans	\$ 2,582	382	73	3,037	\$ 1,930	(169)	(30)		1,731
Investment securities	(25)	18	(1)	(8)	(101)	(15)	3		(113)
Federal funds sold	62	61	67	190	2	9	1		12
Total interest income	2,619	461	139	3,219	1,831	(175)	(26)		1,630
Interest expense									
Deposits	404	820	265	1,489	143	103	15		261
FHLB advances and other borrowings	(714)	(9)	7	(716)	58	1	-		59
Junior subordinated debt	-	11	-	11	-	10	-		10
Total interest expense	(310)	822	272	784	201	114	15		330
Net interest income	\$ 2,929	(361)	(133)	2,435	\$ 1,630	(289)	(41)		1,300

Net interest income, the largest component of our income, was \$14.0 million for the three-month period ended March 31, 2018 and \$11.6 million for the three months ended March 31, 2017, a \$2.4 million, or 21.0%, increase during the first quarter of 2018. The increase in net interest income is due to a \$3.2 million increase in interest income, partially offset by a \$784,000 increase in interest expense. During the first quarter of 2018, the primary driver of the increase in net interest income was the \$259.0 million increase in our average interest-earning assets as compared to the first quarter of 2017.

### *Provision for Loan Losses*

We have established an allowance for loan losses through a provision for loan losses charged as an expense on our consolidated statements of income. We review our loan portfolio periodically to evaluate our outstanding loans and to measure both the performance of the portfolio and the adequacy of the allowance for loan losses. Please see the discussion below under "Balance Sheet Review – Allowance for Loan Losses" for a description of the factors we consider in determining the amount of the provision we expense each period to maintain this allowance.

For each of the three months ended March 31, 2018 and 2017, we incurred a noncash expense related to the provision for loan losses of \$500,000, which resulted in an allowance for loan losses of \$15.9 million, or 1.09% of gross loans, for the 2018 period and an allowance for loan losses of \$15.3 million, or 1.25% of gross loans, for the 2017 period. During the past 12 months, our loan balances increased by \$240.7 million, while the percentage of our nonperforming loans and classified loans have declined. Factors such as these are also considered in determining the amount of loan loss provision necessary to maintain our allowance for loan losses at an adequate level.



## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

### *Noninterest Income*

The following table sets forth information related to our noninterest income.

(dollars in thousands)	<b>Three months ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
Mortgage banking income	\$ 1,328	1,057
Service fees on deposit accounts	257	278
ATM and debit card income	334	263
Income from bank owned life insurance	220	183
Other income	281	270
<b>Total noninterest income</b>	<b>\$ 2,420</b>	<b>2,051</b>

Noninterest income increased \$369,000, or 18.0%, for the first quarter of 2018 as compared to the same period in 2017. The increase in total noninterest income during the 2018 period resulted primarily from the following:

Mortgage banking income increased by \$271,000, or 25.6%, driven by higher mortgage origination volume during the first quarter of 2018.

ATM and debit card income increased by \$71,000, or 27.1%, driven by an increase in transaction volume.

### *Noninterest expenses*

The following table sets forth information related to our noninterest expenses.

(dollars in thousands)	<b>Three months ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
Compensation and benefits	\$ 5,843	5,273
Occupancy	1,137	967
Outside service and data processing	736	745
Insurance	313	289
Professional fees	476	313
Marketing	209	210
Other	491	563
<b>Total noninterest expense</b>	<b>\$ 9,205</b>	<b>8,360</b>

Noninterest expense was \$9.2 million for the three months ended March 31, 2018, an \$845,000, or 10.1%, increase from noninterest expense of \$8.4 million for the three months ended March 31, 2017. Significant fluctuations in noninterest expenses resulted from the following:

Compensation and benefits expense increased \$570,000, or 10.8%, relating primarily to increases in base compensation, incentive compensation and benefits expenses. Base compensation increased by \$538,000 driven by the cost of 27 additional employees, four of which were hired in conjunction with the opening of our new office in Atlanta, Georgia; five of which were hired as additional team leaders or mortgage executives in our existing markets; and the remainder being hired to support loan, deposit and corporate growth. Incentive compensation increased by \$30,000 and benefits expense increased by \$18,000 during the 2018 period. The increase in incentive compensation related to the additional number of employees at March 31, 2018 while the increase in benefits expenses was driven by an increase in payroll taxes and partially offset by a decrease in group insurance costs for the 2018 period.

Occupancy expenses increased by \$170,000, or 17.6%, driven by increased rent expense as well as additional insurance, depreciation and other maintenance expenses due to our new properties in Charleston, South Carolina and Raleigh, North Carolina.

Professional fees increased by \$163,000, or 52.1%, due to increased loan appraisal and legal costs as well as professional service fees related to our mortgage operations.

## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

Partially offsetting the increases in noninterest expense was a decrease in other expenses of \$72,000, or 12.8%, due primarily to fewer deposit account losses, real estate owned expenses and collection expenses paid in the 2018 period.

Our efficiency ratio was 55.9% for the first quarter of 2018 compared to 61.2% for the same period in 2017. The efficiency ratio represents the percentage of one dollar of expense required to be incurred to earn a full dollar of revenue and is computed by dividing noninterest expense by the sum of net interest income and noninterest income. The improvement during the 2018 period relates primarily to the increase in interest and noninterest income partially offset with the increase in noninterest expenses compared to the prior year.

We incurred income tax expense of \$1.5 million and \$1.7 million for the three months ended March 31, 2018 and 2017, respectively. Our effective tax rate was 22.8% and 35.1% for the three months ended March 31, 2018 and 2017, respectively. The decrease in the effective tax rate during the 2018 period is a result of The Tax Act which was passed in December 2017.

### Balance Sheet Review

#### *Investment Securities*

At March 31, 2018, the \$61.6 million in our investment securities portfolio represented approximately 3.6% of our total assets. Our available for sale investment portfolio included US government agency securities, SBA securities, state and political subdivisions, and mortgage-backed securities with a fair value of \$58.5 million and an amortized cost of \$60.0 million resulting in an unrealized loss of \$1.5 million. At December 31, 2017, the \$72.1 million in our investment securities portfolio represented approximately 4.4% of our total assets. At December 31, 2017, we held investment securities available for sale with a fair value of \$67.6 million and an amortized cost of \$68.2 million for an unrealized loss of \$578,000.

#### *Loans*

Since loans typically provide higher interest yields than other types of interest earning assets, a substantial percentage of our earning assets are invested in our loan portfolio. Average loans for the three months ended March 31, 2018 and 2017 were \$1.4 billion and \$1.2 billion, respectively. Before the allowance for loan losses, total loans outstanding at March 31, 2018 and December 31, 2017 were \$1.5 billion and \$1.4 billion, respectively.

The principal component of our loan portfolio is loans secured by real estate mortgages. As of March 31, 2018, our loan portfolio included \$1.2 billion, or 82.3%, of real estate loans. As of December 31, 2017, real estate loans made up 82.1% of our loan portfolio and totaled \$1.1 billion. Most of our real estate loans are secured by residential or commercial property. We obtain a security interest in real estate, in addition to any other available collateral. This collateral is taken to increase the likelihood of the ultimate repayment of the loan. Generally, we limit the loan-to-value ratio on loans to coincide with the appropriate regulatory guidelines. We attempt to maintain a relatively diversified loan portfolio to help reduce the risk inherent in concentration in certain types of collateral and business types. We do not generally originate traditional long-term residential mortgages to hold in our loan portfolio, but we do issue traditional second mortgage residential real estate loans and home equity lines of credit. Home equity lines of credit totaled \$155.5 million as of March 31, 2018, of which approximately 42% were in a first lien position, while the remaining balance was second liens, compared to \$156.1 million as of December 31, 2017, with approximately 40% in first lien positions and the remaining balance in second liens. The average loan had a balance of approximately \$88,000 and a loan to value of 71% as of March 31, 2018, compared to an average loan balance of \$89,000 and a loan to value of approximately 71% as of December 31, 2017. Further, 1.1% and 0.8% of our total home equity lines of credit were over 30 days past due as of March 31, 2018 and December 31, 2017, respectively.

## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

Following is a summary of our loan composition at March 31, 2018 and December 31, 2017. During the first three months of 2018, our loan portfolio increased by \$72.3 million, or 5.2%. Our commercial and consumer loan portfolios each experienced growth during the three months ended March 31, 2018 with a 6.9% increase in commercial loans and a 2.0% increase in consumer loans during the period. Of the \$72.3 million in loan growth during the first three months of 2018, \$62.8 million of the increase was in loans secured by real estate, \$8.7 million in commercial business loans, and \$0.8 million in other consumer loans. Our consumer real estate portfolio includes high quality 1-4 family consumer real estate loans. Our average consumer real estate loan currently has a principal balance of \$377,000, a term of ten years, and an average rate of 4.31% as of March 31, 2018, compared to \$375,000 a term of ten years, and an average rate of 4.30% as of December 31, 2017.

(dollars in thousands)	<b>March 31, 2018</b>		<b>December 31, 2017</b>	
	<b>Amount</b>	<b>% of Total</b>	<b>Amount</b>	<b>% of Total</b>
<b>Commercial</b>				
Owner occupied RE	\$ 339,444	23.3%	\$ 316,818	22.8%
Non-owner occupied RE	339,231	23.2 %	312,798	22.6 %
Construction	56,210	3.8%	51,179	3.7%
Business	234,820	16.1 %	226,158	16.3 %
Total commercial loans	969,705	66.4 %	906,953	65.4 %
<b>Consumer</b>				
Real estate	275,731	18.9%	273,050	19.7%
Home equity	155,507	10.7 %	156,141	11.3 %
Construction	35,017	2.4%	28,351	2.0%
Other	23,422	1.6 %	22,575	1.6 %
Total consumer loans	489,677	33.6 %	480,117	34.6 %
Total gross loans, net of deferred fees	1,459,382	100.0 %	1,387,070	100.0 %
Less—allowance for loan losses	(15,852 )		(15,523 )	
Total loans, net	\$ 1,443,530		\$ 1,371,547	

### *Nonperforming assets*

Nonperforming assets include real estate acquired through foreclosure or deed taken in lieu of foreclosure and loans on nonaccrual status. 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. Our policy with respect to nonperforming loans requires the borrower to make a minimum of six consecutive payments in accordance with the loan terms and to show capacity to continue performing into the future before that loan can be placed back on accrual status. As of March 31, 2018 and December 31, 2017, we had no loans 90 days past due and still accruing.

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

(dollars in thousands)	<b>March 31, 2018</b>	<b>December 31, 2017</b>
Commercial	\$ 1,627	2,491
Consumer	2,821	2,137
Nonaccruing troubled debt restructurings	2,826	2,673
Total nonaccrual loans	7,274	7,301
Other real estate owned	242	242
Total nonperforming assets	\$ 7,516	7,543

At March 31, 2018, nonperforming assets were \$7.5 million, or 0.43% of total assets and 0.52% of gross loans. Comparatively, nonperforming assets were \$7.5 million, or 0.46% of total assets and 0.54% of gross loans at December 31, 2017. Nonaccrual loans were \$7.3 million at March 31, 2018, a slight decrease from December 31, 2017. During the first three months of 2018, two loans were put on nonaccrual status and three nonaccrual loans were either paid off or returned to accrual status. The amount of foregone interest income on the nonaccrual loans in the first three months of 2018 and 2017 was approximately \$72,000 and \$112,000, respectively.

## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

Nonperforming assets include other real estate owned which totaled \$242,000 at March 31, 2018 and December 31, 2017. The balance at March 31, 2018 includes three commercial properties totaling \$242,000. All of these properties are located in the Upstate of South Carolina. We believe that these properties are appropriately valued at the lower of cost or market as of March 31, 2018.

At March 31, 2018 and 2017, the allowance for loan losses represented 217.9% and 247.4% of the total amount of nonperforming loans, respectively. A significant portion, or 95%, of nonperforming loans at March 31, 2018 is secured by real estate. Our nonperforming loans have been written down to approximately 62% of their original nonperforming balance. We have evaluated the underlying collateral on these loans and believe that the collateral on these loans is sufficient to minimize future losses. Based on the level of coverage on nonperforming loans and analysis of our loan portfolio, we believe the allowance for loan losses of \$15.9 million as of March 31, 2018 to be adequate.

As a general practice, most of our loans are originated with relatively short maturities of less than 10 years. As a result, when a loan reaches its maturity we frequently renew the loan and thus extend its maturity using the same credit standards as those used when the loan was first originated. Due to these loan practices, we may, at times, renew loans which are classified as nonperforming after evaluating the loan's collateral value and financial strength of its guarantors. Nonperforming loans are renewed at terms generally consistent with the ultimate source of repayment and rarely at reduced rates. In these cases the Company will seek additional credit enhancements, such as additional collateral or additional guarantees to further protect the loan. When a loan is no longer performing in accordance with its stated terms, the Company will typically seek performance under the guarantee.

In addition, at March 31, 2018, 82.3% of our loans are collateralized by real estate and 87% of our impaired loans are secured by real estate. The Company utilizes third party appraisers to determine the fair value of collateral dependent loans. Our current loan and appraisal policies require the Company to obtain updated appraisals on an annual basis, either through a new external appraisal or an appraisal evaluation. Impaired loans are individually reviewed on a quarterly basis to determine the level of impairment. As of March 31, 2018, we do not have any impaired real estate loans carried at a value in excess of the appraised value. We typically charge-off a portion or create a specific reserve for impaired loans when we do not expect repayment to occur as agreed upon under the original terms of the loan agreement.

At March 31, 2018, impaired loans totaled \$12.9 million for which \$9.3 million of these loans have a reserve of approximately \$3.7 million allocated in the allowance. During the first three months of 2018, the average recorded investment in impaired loans was approximately \$13.1 million. Comparatively, impaired loans totaled \$12.4 million at December 31, 2017, and \$8.0 million of these loans had a reserve of approximately \$3.7 million allocated in the allowance. During 2017, the average recorded investment in impaired loans was approximately \$13.0 million.

We consider a loan to be a TDR when the debtor experiences financial difficulties and we provide concessions such that we will not collect all principal and interest in accordance with the original terms of the loan agreement. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of our workout plan for individual loan relationships, we may restructure loan terms to assist borrowers facing challenges in the current economic environment. As of March 31, 2018, we determined that we had loans totaling \$8.5 million that we considered TDRs. As of December 31, 2017, we had loans totaling \$7.8 million, that we considered TDRs.

### *Allowance for Loan Losses*

The allowance for loan losses was \$15.9 million and \$15.3 million at March 31, 2018 and 2017, respectively, or 1.09% of outstanding loans at March 31, 2018 and 1.25% of outstanding loans at March 31, 2017. At December 31, 2017, our allowance for loan losses was \$15.5 million, or 1.12% of outstanding loans, and we had net loans charged-off of \$1.3 million for the year ended December 31, 2017.

During the three months ended March 31, 2018, we charged-off \$293,000 of loans and recorded \$122,000 of recoveries on loans previously charged-off, for net charge-offs of \$171,000, or 0.05% of average loans, annualized. Comparatively, we charged-off \$190,000 of loans and recorded \$122,000 of recoveries on loans previously charged-off, resulting in net charge-offs of \$68,000, or 0.02% of average loans, annualized, for the first three months of 2017.

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

Following is a summary of the activity in the allowance for loan losses.

	Three months ended		Year ended December 31, 2017
	March 31, 2018	2017	
(dollars in thousands)			
<b>Balance, beginning of period</b>	\$ 15,523	14,855	14,855
Provision	500	500	2,000
Loan charge-offs	(293 )	(190 )	(1,638 )
Loan recoveries	122	122	306
Net loan charge-offs	(171 )	(68 )	(1,332 )
<b>Balance, end of period</b>	\$ 15,852	15,287	15,523

*Deposits and Other Interest-Bearing Liabilities*

Our primary source of funds for loans and investments is our deposits, advances from the FHLB, and structured repurchase agreements. In the past, we have chosen to obtain a portion of our certificates of deposits from areas outside of our market in order to obtain longer term deposits than are readily available in our local market. We have adopted guidelines regarding our use of brokered CDs that limit our brokered CDs to 20% of total deposits and dictate that our current interest rate risk profile determines the terms. In addition, we do not obtain time deposits of \$100,000 or more through the Internet. These guidelines allow us to take advantage of the attractive terms that wholesale funding can offer while mitigating the related inherent risk.

Our retail deposits represented \$1.5 billion, or 96.1% of total deposits at March 31, 2018, while our out-of-market, or brokered, deposits represented \$59.8 million, or 3.9% of our total deposits at March 31, 2018. At December 31, 2017, retail deposits represented \$1.4 billion, or 98.0% of our total deposits, and brokered CDs were \$28.1 million, representing 2.0% of our total deposits. Our loan-to-deposit ratio was 96% at March 31, 2018 and 100% at December 31, 2017.

The following is a detail of our deposit accounts:

	March 31, 2018	December 31, 2017
(dollars in thousands)		
Non-interest bearing	\$ 297,892	295,680
Interest bearing:		
NOW accounts	243,418	229,945
Money market accounts	642,333	545,029
Savings	15,952	16,298
Time, less than \$100,000	56,778	55,461
Time and out-of-market deposits, \$100,000 and over	264,150	238,710
Total deposits	\$ 1,520,523	1,381,123

During the past 12 months, we continued our focus on increasing core deposits, which exclude out-of-market deposits and time deposits of \$250,000 or more, in order to provide a relatively stable funding source for our loan portfolio and other earning assets. Our core deposits were \$1.3 billion and \$1.2 billion at March 31, 2018, and December 31, 2017, respectively.

## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

The following table shows the average balance amounts and the average rates paid on deposits.

(dollars in thousands)	March 31,		Three months ended	
	Amount	2018 Rate	Amount	2017 Rate
Noninterest bearing demand deposits	\$ 282,559	-	\$ 239,873	-
Interest bearing demand deposits	238,690	0.15%	219,743	0.18%
Money market accounts	579,088	1.10%	371,985	0.60%
Savings accounts	16,286	0.06%	15,228	0.05%
Time deposits less than \$100,000	56,425	1.14%	48,013	0.68%
Time deposits greater than \$100,000	258,919	1.43%	224,201	0.94%
<b>Total deposits</b>	<b>\$ 1,431,967</b>	<b>0.77%</b>	<b>\$ 1,119,043</b>	<b>0.45%</b>

During the three months ended March 31, 2018, our average transaction account balances increased by \$269.8 million, or 31.9%, from the three months ended March 31, 2017, while our average time deposit balances increased by \$43.1 million, or 15.8%, during the same twelve-month period.

All of our time deposits are certificates of deposits. The maturity distribution of our time deposits of \$100,000 or more at March 31, 2018 was as follows:

(dollars in thousands)	March 31, 2018
Three months or less	\$ 42,903
Over three through six months	52,423
Over six through twelve months	85,897
Over twelve months	82,927
<b>Total</b>	<b>\$ 264,150</b>

Included in time deposits of \$100,000 or more at March 31, 2018 is \$39.8 million of wholesale CDs scheduled to mature within the next 12 months at a weighted average rate of 1.68%. Time deposits that meet or exceed the FDIC insurance limit of \$250,000 at March 31, 2018 and December 31, 2017 were \$182.6 million and \$131.7 million, respectively.

### Liquidity and Capital Resources

Liquidity represents the ability of a company to convert assets into cash or cash equivalents without significant loss, and the ability to raise additional funds by increasing liabilities. Liquidity management involves monitoring our sources and uses of funds in order to meet our day-to-day cash flow requirements while maximizing profits. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of our investment portfolio is fairly predictable and subject to a high degree of control at the time investment decisions are made. However, net deposit inflows and outflows are far less predictable and are not subject to the same degree of control.

At March 31, 2018 and December 31, 2017, cash and cash equivalents amounted to \$136.1 million and \$92.2 million, respectively, or 7.9% and 5.7% of total assets, respectively. Our investment securities at March 31, 2018 and December 31, 2017 amounted to \$61.6 million and \$72.1 million, respectively, or 3.6% and 4.4% of total assets, respectively. The increase in cash and cash equivalents is primarily attributable to our effort to increase the amount of on balance sheet liquidity. In addition, investment securities traditionally provide a secondary source of liquidity since they can be converted into cash in a timely manner; however, approximately 6.9% of these securities are pledged against outstanding debt. Therefore, the related debt would need to be repaid prior to the securities being sold in order for these securities to be converted to cash.

## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

Our ability to maintain and expand our deposit base and borrowing capabilities serves as our primary source of liquidity. We plan to meet our future cash needs through the liquidation of temporary investments, the generation of deposits, loan payoffs, and from additional borrowings. In addition, we will receive cash upon the maturity and sale of loans and the maturity of investment securities. We maintain four federal funds purchased lines of credit with correspondent banks totaling \$72.0 million for which there were no borrowings against the lines of credit at March 31, 2018.

We are also a member of the FHLB, from which applications for borrowings can be made. The FHLB requires that securities, qualifying mortgage loans, and stock of the FHLB owned by the Bank be pledged to secure any advances from the FHLB. The unused borrowing capacity currently available from the FHLB at March 31, 2018 was \$226.4 million, based on the Bank's \$2.5 million investment in FHLB stock, as well as qualifying mortgages available to secure any future borrowings. However, we are able to pledge additional securities to the FHLB in order to increase our available borrowing capacity. In addition, at March 31, 2018 and December 31, 2017 we had \$235.9 million and \$165.1 million, respectively, of letters of credit outstanding with the FHLB to secure client deposits.

We also have a line of credit with another financial institution for \$15.0 million, which was unused at March 31, 2018. The line of credit bears interest at LIBOR plus 2.50% and matures on June 30, 2020.

We believe that our existing stable base of core deposits, borrowings from the FHLB, and short-term repurchase agreements will enable us to successfully meet our long-term liquidity needs. However, as short-term liquidity needs arise, we have the ability to sell a portion of our investment securities portfolio to meet those needs.

Total shareholders' equity was \$154.7 million at March 31, 2018 and \$149.7 million at December 31, 2017. The \$5.0 million increase from December 31, 2017 is primarily related to net income of \$5.2 million during the first three months of 2018 as well as an increase of \$565,000 from the exercise of stock options and partially offset by a \$726,000 decrease in accumulated other comprehensive income.

The following table shows the return on average assets (net income divided by average total assets), return on average equity (net income divided by average equity), equity to assets ratio (average equity divided by average assets), and tangible common equity ratio (total equity less preferred stock divided by total assets) annualized for the three months ended March 31, 2018 and the year ended December 31, 2017. Since our inception, we have not paid cash dividends.

	<b>March 31, 2018</b>	<b>December 31, 2017</b>
Return on average assets	1.28%	0.87%
Return on average equity	13.88%	9.66%
Return on average common equity	13.88%	9.66%
Average equity to average assets ratio	9.26%	8.98%
Tangible common equity to assets ratio	8.95 %	9.21 %

Under the capital adequacy guidelines, regulatory capital is classified into two tiers. These guidelines require an institution to maintain a certain level of Tier 1 and Tier 2 capital to risk-weighted assets. Tier 1 capital consists of common shareholders' equity, excluding the unrealized gain or loss on securities available for sale, minus certain intangible assets. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100% based on the risks believed to be inherent in the type of asset. Tier 2 capital consists of Tier 1 capital plus the general reserve for loan losses, subject to certain limitations. We are also required to maintain capital at a minimum level based on total average assets, which is known as the Tier 1 leverage ratio.

At both the holding company and Bank level, we are subject to various regulatory capital requirements administered by the federal banking agencies. To be considered "well-capitalized," we must maintain total risk-based capital of at least 10%, Tier 1 capital of at least 6%, and a leverage ratio of at least 5%. To be considered "adequately capitalized" under these capital guidelines, we must maintain a minimum total risk-based capital of 8%, with at least 4% being Tier 1 capital. In addition, we must maintain a minimum Tier 1 leverage ratio of at least 4%. As of March 31, 2018, our capital ratios exceed these ratios and we remain "well capitalized."

Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

The following table summarizes the capital amounts and ratios of the Bank and the regulatory minimum requirements.

		<b>March 31, 2018</b>				<b>To be well capitalized under prompt corrective action provisions minimum</b>	
		<b>Actual</b>		<b>For capital adequacy purposes minimum</b>			
(dollars in thousands)		<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
Total Capital (to risk weighted assets)		\$ 180,699	12.73%	113,591	8.00%	141,989	10.00%
Tier 1 Capital (to risk weighted assets)		164,847	11.61%	85,193	6.00%	113,591	8.00%
Common Equity Tier 1 Capital (to risk weighted assets)		164,847	11.61%	63,895	4.50%	92,293	6.50%
Tier 1 Capital (to average assets)		164,847	10.01%	65,872	4.00%	82,341	5.00%

		<b>December 31, 2017</b>				<b>To be well capitalized under prompt corrective action provisions minimum</b>	
		<b>Actual</b>		<b>For capital adequacy purposes minimum</b>			
(dollars in thousands)		<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
Total Capital (to risk weighted assets)		\$ 175,016	12.99%	\$ 107,749	8.00%	\$ 134,686	10.00%
Tier 1 Capital (to risk weighted assets)		159,493	11.84%	80,812	6.00%	107,749	8.00%
Common Equity Tier 1 Capital (to risk weighted assets)		159,493	11.84%	60,609	4.50%	87,546	6.50%
Tier 1 Capital (to average assets)		159,493	10.04%	63,573	4.00%	79,466	5.00%

The following table summarizes the capital amounts and ratios of the Company and the minimum regulatory requirements.

		<b>March 31, 2018</b>				<b>To be well capitalized under prompt corrective action provisions minimum</b>	
		<b>Actual</b>		<b>For capital adequacy purposes minimum</b>			
(dollars in thousands)		<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
Total Capital (to risk weighted assets)		\$ 184,773	13.01%	113,591	8.00%	N/A	N/A
Tier 1 Capital (to risk weighted assets)		168,921	11.90%	85,193	6.00%	N/A	N/A
Common Equity Tier 1 Capital (to risk weighted assets)		155,921	10.98%	63,895	4.50%	N/A	N/A
Tier 1 Capital (to average assets)		168,921	10.27%	65,814	4.00%	N/A	N/A

		<b>December 31, 2017</b>				<b>To be well capitalized under prompt corrective action provisions minimum</b>	
		<b>Actual</b>		<b>For capital adequacy purposes minimum</b>			
(dollars in thousands)		<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
Total Capital (to risk weighted assets)		\$ 178,665	13.27%	107,749	8.00%	N/A	N/A
Tier 1 Capital (to risk weighted assets)		163,142	12.11%	80,812	6.00%	N/A	N/A
Common Equity Tier 1 Capital (to risk weighted assets)		150,142	11.15%	60,609	4.50%	N/A	N/A
Tier 1 Capital (to average assets)		163,142	10.26%	63,573	4.00%	N/A	N/A

The ability of the Company to pay cash dividends is dependent upon receiving cash in the form of dividends from the Bank. The dividends that may be paid by the Bank to the Company are subject to legal limitations and regulatory capital requirements.

## **EFFECT OF INFLATION AND CHANGING PRICES**

The effect of relative purchasing power over time due to inflation has not been taken into account in our consolidated financial statements. Rather, our financial statements have been prepared on an historical cost basis in accordance with generally accepted accounting principles.

Unlike most industrial companies, our assets and liabilities are primarily monetary in nature. Therefore, the effect of changes in interest rates will have a more significant impact on our performance than will the effect of changing prices and inflation in general. In addition, interest rates may generally increase as the rate of inflation increases, although not necessarily in the same magnitude. As discussed previously, we seek to manage the relationships between interest sensitive assets and liabilities in order to protect against wide rate fluctuations, including those resulting from inflation.

## **OFF-BALANCE SHEET RISK**

Commitments to extend credit are agreements to lend money to a client as long as the client has not violated any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At March 31, 2018, unfunded commitments to extend credit were \$355.5 million, of which \$120.3 million was at fixed rates and \$235.2 million was at variable rates. At December 31, 2017, unfunded commitments to extend credit were \$310.6 million, of which approximately \$85.2 million was at fixed rates and \$225.4 million was at variable rates. A significant portion of the unfunded commitments related to consumer equity lines of credit. Based on historical experience, we anticipate that a significant portion of these lines of credit will not be funded. We evaluate each client's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on our credit evaluation of the borrower. The type of collateral varies but may include accounts receivable, inventory, property, plant and equipment, and commercial and residential real estate.

At March 31, 2018 and December 31, 2017, there were commitments under letters of credit for \$6.2 million and \$6.3 million, respectively. The credit risk and collateral involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Since most of the letters of credit are expected to expire without being drawn upon, they do not necessarily represent future cash requirements.

A portion of our business is to originate mortgage loans that will be sold in the secondary market to investors. Loan types that we originate include conventional loans, jumbo loans and other governmental agency loan products. We adhere to the legal lending limits and guidelines as set forth by the various governmental agencies and investors to whom we sell loans. Under a "best efforts" selling procedure, we make our best effort to process, fund, and deliver the loan to a particular investor. If the loan fails to fund, there is no immediate cost to us, as the market risk has been transferred to the investor. In the event of a customer loan default, we may be required to reimburse the investor.

Except as disclosed in this report, we are not involved in off-balance sheet contractual relationships, unconsolidated related entities that have off-balance sheet arrangements or transactions that could result in liquidity needs or other commitments that significantly impact earnings.

## **MARKET RISK AND INTEREST RATE SENSITIVITY**

Market risk is the risk of loss from adverse changes in market prices and rates, which principally arises from interest rate risk inherent in our lending, investing, deposit gathering, and borrowing activities. Other types of market risks, such as foreign currency exchange rate risk and commodity price risk, do not generally arise in the normal course of our business.

We actively monitor and manage our interest rate risk exposure in order to control the mix and maturities of our assets and liabilities utilizing a process we call asset/liability management. The essential purposes of asset/liability management are to ensure adequate liquidity and to maintain an appropriate balance between interest sensitive assets and liabilities in order to minimize potentially adverse impacts on earnings from changes in market interest rates. Our asset/liability management committee ("ALCO") monitors and considers methods of managing exposure to interest rate risk. We have both an internal ALCO consisting of senior management that meets at various times during each month and a board ALCO that meets monthly. The ALCOs are responsible for maintaining the level of interest rate sensitivity of our interest sensitive assets and liabilities within board-approved limits.

## Edgar Filing: SOUTHERN FIRST BANCSHARES INC - Form 10-Q

As of March 31, 2018, the following table summarizes the forecasted impact on net interest income using a base case scenario given upward and downward movements in interest rates of 100, 200, and 300 basis points based on forecasted assumptions of prepayment speeds, nominal interest rates and loan and deposit repricing rates. Estimates are based on current economic conditions, historical interest rate cycles and other factors deemed to be relevant. However, underlying assumptions may be impacted in future periods which were not known to management at the time of the issuance of the Consolidated Financial Statements. Therefore, management's assumptions may or may not prove valid. No assurance can be given that changing economic conditions and other relevant factors impacting our net interest income will not cause actual occurrences to differ from underlying assumptions. In addition, this analysis does not consider any strategic changes to our balance sheet which management may consider as a result of changes in market conditions.

<b>Interest rate scenario</b>	<b>Change in net interest income from base</b>
Up 300 basis points	1.39%
Up 200 basis points	1.77%
Up 100 basis points	1.41%
Base	-
Down 100 basis points	(5.23)%
Down 200 basis points	(7.73)%
Down 300 basis points	(7.83)%

### **CRITICAL ACCOUNTING POLICIES**

We have adopted various accounting policies that govern the application of accounting principles generally accepted in the United States and with general practices within the banking industry in the preparation of our financial statements. Our significant accounting policies are described in the footnotes to our audited consolidated financial statements as of December 31, 2017, as filed in our Annual Report on Form 10-K.

Certain accounting policies involve significant judgments and assumptions by us that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Our Critical Accounting Policies are the allowance for loan losses, fair value of financial instruments, other-than-temporary impairment analysis, other real estate owned, and income taxes. Because of the nature of the judgment and assumptions we make, actual results could differ from these judgments and estimates that could have a material impact on the carrying values of our assets and liabilities and our results of operations.

### **ACCOUNTING, REPORTING, AND REGULATORY MATTERS**

See Note 1 – Nature of Business and Basis of Presentation in the accompanying condensed notes to consolidated financial statements included elsewhere in this report for details of recently issued accounting pronouncements and their expected impact on our consolidated financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

### **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

See Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations – Market Risk and Interest Rate Sensitivity and – Liquidity Risk.

**Item 4. CONTROLS AND PROCEDURES.**

*Evaluation of Disclosure Controls and Procedures*

Management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including our Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control over Financial Reporting*

There has been no change in the Company's internal control over financial reporting during the three months ended March 31, 2018, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS.**

We are a party to claims and lawsuits arising in the course of normal business activities. Management is not aware of any material pending legal proceedings against the Company which, if determined adversely, would have a material adverse impact on the company's financial position, results of operations or cash flows.

**Item 1A RISK FACTORS.**

Investing in shares of our common stock involves certain risks, including those identified and described in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as well as cautionary statements contained in this Form 10-Q, including those under the caption "Cautionary Warning Regarding Forward-Looking Statements" set forth in Part 1, Item 2 of this Form 10-Q, risks and matters described elsewhere in this Form 10-Q, and in our other filings with the SEC.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

Not applicable

**Item 3. DEFAULTS UPON SENIOR SECURITIES.**

Not applicable

**Item 4. MINE SAFETY DISCLOSURES.**

Not applicable

**Item 5. OTHER INFORMATION.**

Not applicable

**Item 6. EXHIBITS.**

The exhibits required to be filed as part of this Quarterly Report on Form 10-Q are listed in the Index to Exhibits attached hereto and are incorporated herein by reference.

**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.

**SOUTHERN FIRST BANCSHARES, INC.**  
Registrant

Date: May 1, 2018 /s/R. Arthur Seaver, Jr.  
R. Arthur Seaver, Jr.  
Chief Executive Officer (Principal Executive Officer)

Date: May 1, 2018 /s/Michael D. Dowling  
Michael D. Dowling  
Chief Financial Officer (Principal Financial and Accounting Officer)

42

---

**INDEX TO EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
<u>31.1</u>	<u>Rule 13a-14(a) Certification of the Principal Executive Officer.</u>
<u>31.2</u>	<u>Rule 13a-14(a) Certification of the Principal Financial Officer.</u>
<u>32</u>	<u>Section 1350 Certifications.</u>
101	The following materials from the Quarterly Report on Form 10-Q of Southern First Bancshares, Inc. for the quarter ended March 31, 2018, formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statement of Changes in Shareholders' Equity, (v) Consolidated Statements of Cash Flows and (vi) Notes to Unaudited Consolidated Financial Statements.
43	

---