

REPUBLIC BANCORP INC /KY/

Form 10-Q

November 07, 2014

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

**x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period ended September 30, 2014**

**or**

**o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**Commission File Number: 0-24649**

# REPUBLIC BANCORP, INC.

(Exact name of registrant as specified in its charter)

**Kentucky**

(State of other jurisdiction of incorporation or organization)

**61-0862051**

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

**601 West Market Street, Louisville, Kentucky**

(Address of principal executive offices)

**40202**

(Zip Code)

**(502) 584-3600**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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:

The number of shares outstanding of the registrant's Class A Common Stock and Class B Common Stock, as of October 31, 2014, was 18,571,000 and 2,245,000, respectively.



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SIGNATURES

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****CONSOLIDATED BALANCE SHEETS** (in thousands) (unaudited)

	September 30, 2014	December 31, 2013
<b>ASSETS</b>		
Cash and cash equivalents	\$ 69,682	\$ 170,863
Securities available for sale	452,974	432,893
Securities held to maturity (fair value of \$47,541 in 2014 and \$50,768 in 2013)	47,247	50,644
Mortgage loans held for sale, at fair value	5,890	3,506
Loans	2,908,535	2,589,792
Allowance for loan losses	(23,617)	(23,026)
Loans, net	2,884,918	2,566,766
Federal Home Loan Bank stock, at cost	28,208	28,342
Premises and equipment, net	32,395	32,908
Goodwill	10,168	10,168
Other real estate owned	11,937	17,102
Bank owned life insurance	51,037	25,086
Other assets and accrued interest receivable	31,163	33,626
<b>TOTAL ASSETS</b>	<b>\$ 3,625,619</b>	<b>\$ 3,371,904</b>
<b>LIABILITIES</b>		
Deposits:		
Non interest-bearing	\$ 534,662	\$ 488,642
Interest-bearing	1,525,174	1,502,215
Total deposits	2,059,836	1,990,857
Securities sold under agreements to repurchase and other short-term borrowings	275,874	165,555
Federal Home Loan Bank advances	662,000	605,000
Subordinated note	41,240	41,240
Other liabilities and accrued interest payable	29,301	26,459
<b>Total liabilities</b>	<b>3,068,251</b>	<b>2,829,111</b>
Commitments and contingent liabilities (Footnote 9)		
<b>STOCKHOLDERS EQUITY</b>		
Preferred stock, no par value		
Class A Common Stock and Class B Common Stock, no par value	4,897	4,894
Additional paid in capital	134,109	133,012
Retained earnings	413,501	401,766
Accumulated other comprehensive income	4,861	3,121

<b>Total stockholders equity</b>	557,368	542,793
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	\$ 3,625,619	\$ 3,371,904

*See accompanying footnotes to consolidated financial statements.*

Table of Contents**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)***(in thousands, except per share data)*

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
<b>INTEREST INCOME:</b>				
Loans, including fees	\$ 30,916	\$ 31,619	\$ 91,188	\$ 95,268
Taxable investment securities	1,896	1,984	5,663	6,000
Federal Home Loan Bank stock and other	332	406	1,195	1,261
Total interest income	33,144	34,009	98,046	102,529
<b>INTEREST EXPENSE:</b>				
Deposits	930	1,043	2,845	3,073
Securities sold under agreements to repurchase and other short-term borrowings	28	11	72	53
Federal Home Loan Bank advances	3,116	3,788	9,947	11,081
Subordinated note	628	628	1,886	1,886
Total interest expense	4,702	5,470	14,750	16,093
<b>NET INTEREST INCOME</b>	<b>28,442</b>	<b>28,539</b>	<b>83,296</b>	<b>86,436</b>
Provision for loan losses	1,510	2,200	1,500	2,480
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>26,932</b>	<b>26,339</b>	<b>81,796</b>	<b>83,956</b>
<b>NON-INTEREST INCOME:</b>				
Service charges on deposit accounts	3,568	3,676	10,426	10,384
Net refund transfer fees	(133)	152	16,091	13,849
Mortgage banking income	876	1,026	2,174	6,480
Debit card interchange fee income	1,551	1,519	5,224	4,986
Bargain purchase gain - First Commercial Bank				1,324
Net gain on sale of other real estate owned	67	403	733	1,714
Increase in cash surrender value of bank owned life insurance	381		951	
Other	834	723	2,388	1,961
Total non-interest income	7,144	7,499	37,987	40,698
<b>NON-INTEREST EXPENSES:</b>				
Salaries and employee benefits	12,164	12,226	40,612	43,426
Occupancy and equipment, net	5,544	5,462	16,874	16,354
Communication and transportation	905	990	2,787	3,011
Marketing and development	1,020	745	2,466	2,418
FDIC insurance expense	424	419	1,407	1,234
Bank franchise tax expense	731	707	3,901	3,279
Data processing	868	934	2,622	2,442
Debit card interchange expense	744	655	2,505	2,216
Supplies	205	228	705	800
Other real estate owned expense	950	497	2,580	2,331
Legal expense	367	1,343	867	3,111
Other	1,900	2,079	6,026	6,555
Total non-interest expenses	25,822	26,285	83,352	87,177
<b>INCOME BEFORE INCOME TAX EXPENSE</b>	<b>8,254</b>	<b>7,553</b>	<b>36,431</b>	<b>37,477</b>
<b>INCOME TAX EXPENSE</b>	<b>3,008</b>	<b>2,950</b>	<b>12,879</b>	<b>13,399</b>
<b>NET INCOME</b>	<b>\$ 5,246</b>	<b>\$ 4,603</b>	<b>\$ 23,552</b>	<b>\$ 24,078</b>

**BASIC EARNINGS PER COMMON SHARE:**

Class A Common Stock	\$	0.25	\$	0.22	\$	1.14	\$	1.16
Class B Common Stock	\$	0.24	\$	0.21	\$	1.09	\$	1.12

**DILUTED EARNINGS PER COMMON SHARE:**

Class A Common Stock	\$	0.25	\$	0.22	\$	1.13	\$	1.16
Class B Common Stock	\$	0.24	\$	0.21	\$	1.08	\$	1.11

**DIVIDENDS DECLARED PER COMMON SHARE:**

Class A Common Stock	\$	0.187	\$	0.176	\$	0.550	\$	0.517
Class B Common Stock	\$	0.170	\$	0.160	\$	0.500	\$	0.470

*See accompanying footnotes to consolidated financial statements.*



Table of Contents**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)***(in thousands)*

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	\$ 5,246	\$ 4,603	\$ 23,552	\$ 24,078
<b>OTHER COMPREHENSIVE INCOME (LOSS):</b>				
Change in fair value of derivatives used for cash flow hedges	28		(676)	
Reclassification amount for derivative losses realized in income	104		303	
Unrealized gain (loss) on securities available for sale	(10)	(198)	2,618	(3,163)
Change in unrealized gain on securities available for sale for which a portion of an other-than-temporary impairment has been recognized in earnings	65	(4)	434	418
Net unrealized gains (losses)	187	(202)	2,679	(2,745)
Tax effect	(66)	71	(939)	962
Total other comprehensive income (loss), net of tax	121	(131)	1,740	(1,783)
<b>COMPREHENSIVE INCOME</b>	<b>\$ 5,367</b>	<b>\$ 4,472</b>	<b>\$ 25,292</b>	<b>\$ 22,295</b>

*See accompanying footnotes to consolidated financial statements.*

Table of Contents**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY (UNAUDITED)****NINE MONTHS ENDED SEPTEMBER 30, 2014**

(in thousands, except per share data)	Class A Shares Outstanding	Common Stock Class B Shares Outstanding	Amount	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders Equity
Balance, January 1, 2014	18,541	2,260	\$ 4,894	\$ 133,012	\$ 401,766	\$ 3,121	\$ 542,793
Net income					23,552		23,552
Net change in accumulated other comprehensive income						1,740	1,740
Dividend declared Common Stock:							
Class A shares (\$0.550 per share)					(10,201)		(10,201)
Class B shares (\$0.500 per share)					(1,126)		(1,126)
Stock options exercised, net of shares redeemed	26		6	681	(244)		443
Repurchase of Class A Common Stock	(15)		(3)	(95)	(249)		(347)
Conversion of Class B Common Stock to Class A Common Stock	15	(15)					
Net change in notes receivable on Class A Common Stock							
Deferred director compensation expense - Class A Common Stock	2			145			145
Stock based compensation - restricted stock	(2)			328	3		331
Stock based compensation expense - options				38			38
Balance, September 30, 2014	18,567	2,245	\$ 4,897	\$ 134,109	\$ 413,501	\$ 4,861	\$ 557,368

See accompanying footnotes to consolidated financial statements.

Table of Contents**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

NINE MONTHS ENDED SEPTEMBER 30, 2014 AND 2013 (in thousands)

	2014	2013
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 23,552	\$ 24,078
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of premises and equipment	4,753	3,846
Amortization (accretion) on investment securities, net	446	328
Amortization (accretion) on loans, net	(5,618)	(7,880)
Amortization of mortgage servicing rights	996	1,811
Amortization of core deposit intangible asset		221
Provision for loan losses	1,500	2,480
Net gain on sale of mortgage loans held for sale	(1,894)	(6,340)
Origination of mortgage loans held for sale	(54,046)	(263,411)
Proceeds from sale of mortgage loans held for sale	53,556	270,562
Net realized recovery of mortgage servicing rights		(345)
Net gain on sale of other real estate owned	(733)	(1,714)
Writedowns of other real estate owned	2,042	1,074
Deferred director compensation expense - Company Stock	145	152
Stock based compensation expense	366	401
Bargain purchase gain on acquisition		(1,324)
Increase in cash surrender value of bank owned life insurance	(951)	
Net change in other assets and liabilities:		
Accrued interest receivable	(283)	1,115
Accrued interest payable	(310)	32
Other assets	1,750	4,137
Other liabilities	1,500	(7,447)
Net cash provided by operating activities	26,771	21,776
<b>INVESTING ACTIVITIES:</b>		
Purchases of securities available for sale	(119,427)	(175,275)
Purchases of securities to be held to maturity		(15,000)
Proceeds from calls, maturities and paydowns of securities available for sale	102,111	129,041
Proceeds from calls, maturities and paydowns of securities to be held to maturity	3,342	8,900
Proceeds from sales of Federal Home Loan Bank stock	134	35
Proceeds from sales of other real estate owned	8,991	19,642
Net change in outstanding warehouse lines of credit	(123,008)	93,766
Purchase of loans, including premiums paid	(144,669)	
Net change in other loans	(51,492)	1,718
Purchase of bank owned life insurance	(25,000)	
Net purchases of premises and equipment	(4,240)	(3,275)
Net cash provided by (used in) investing activities	(353,258)	59,552
<b>FINANCING ACTIVITIES:</b>		
Net change in deposits	68,979	36,857
Net change in securities sold under agreements to repurchase and other short-term borrowings	110,319	(144,511)
Payments of Federal Home Loan Bank advances	(108,000)	(25,580)
Proceeds from Federal Home Loan Bank advances	165,000	70,000
Repurchase of Common Stock	(347)	(4,095)
Net proceeds from Common Stock options exercised	443	295
Cash dividends paid	(11,088)	(10,400)

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Net cash provided by (used in) financing activities	225,306	(77,434)
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>(101,181)</b>	<b>3,894</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>170,863</b>	<b>137,691</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$ 69,682</b>	<b>\$ 141,585</b>

*(continued)*

Table of Contents**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

NINE MONTHS ENDED SEPTEMBER 30, 2014 AND 2013 (in thousands)

	2014	2013
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for:		
Interest	\$ 15,060	\$ 16,061
Income taxes	13,703	26,674
<b>SUPPLEMENTAL NONCASH DISCLOSURES:</b>		
Transfers from loans to real estate acquired in settlement of loans	\$ 6,466	\$ 8,690
Loans provided for sales of other real estate owned	1,331	644
Change in fair value of derivatives used for cash flow hedges	(676)	
Change in fair value of available for sale securities	3,052	(2,745)

See accompanying footnotes to consolidated financial statements.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013 (UNAUDITED) AND DECEMBER 31, 2013**

**1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation** The consolidated financial statements include the accounts of Republic Bancorp, Inc. (the Parent Company ) and its wholly-owned subsidiaries, Republic Bank & Trust Company ( RB&T or the Bank ) and Republic Insurance Services, Inc. (the Captive ). RB&T is a Kentucky-based, state chartered non-member financial institution. The Captive, which was formed during the third quarter of 2014, is a wholly-owned insurance subsidiary of the Company that provides property and casualty insurance coverage to the Company and the Bank. The Captive provides reinsurance to five other third party insurance captives for which insurance may not be currently available or economically feasible in today s insurance marketplace. Republic Bancorp Capital Trust ( RBCT ) is a Delaware statutory business trust that is a wholly-owned unconsolidated finance subsidiary of Republic Bancorp, Inc. All companies are collectively referred to as Republic or the Company. All significant intercompany balances and transactions are eliminated in consolidation.

During the second quarter of 2014, Republic Bank, the Company s wholly-owned, federally chartered savings institution, was legally merged into RB&T. The merged institution operates under the name Republic Bank & Trust Company. The merger did not materially impact the Company s consolidated financial statements.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included. Operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. For further information, refer to the consolidated financial statements and footnotes thereto included in Republic s Form 10-K for the year ended December 31, 2013.

As of September 30, 2014, the Company was divided into three distinct business operating segments: Traditional Banking, Mortgage Banking and Republic Processing Group ( RPG ). Tax Refund Solutions ( TRS ), Republic Payment Solutions ( RPS ) and Republic Credit Solutions ( RCS ) operate as divisions of the RPG segment. The TRS division comprises the substantial majority of revenues and expenses of RPG. The RPS and RCS divisions are considered immaterial for separate and independent segment reporting.

**Traditional Banking and Mortgage Banking (collectively Core Banking )**

As of September 30, 2014, in addition to an Internet delivery channel, Republic had 42 full-service banking centers with locations as follows:

- Kentucky 33

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- Metropolitan Louisville 20
- Central Kentucky 8
- Elizabethtown 1
- Frankfort 1
- Georgetown 1
- Lexington 4
- Shelbyville 1
- Western Kentucky 2
- Owensboro 2
- Northern Kentucky 3
- Covington 1
- Florence 1
- Independence 1
- Southern Indiana 3
- Floyds Knobs 1
- Jeffersonville 1
- New Albany 1
- Metropolitan Tampa, Florida 3
- Metropolitan Cincinnati, Ohio 1
- Metropolitan Nashville, Tennessee 2

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Republic's headquarters are located in Louisville, which is the largest city in Kentucky based on population.

Core Banking results of operations are primarily dependent upon net interest income, which represents the difference between the interest income and fees on interest-earning assets and the interest expense on interest-bearing liabilities. Principal interest-earning Core Banking assets represent investment securities and commercial and consumer loans primarily secured by real estate and/or personal property. Interest-bearing liabilities primarily consist of interest-bearing deposit accounts, securities sold under agreements to repurchase, as well as short-term and long-term borrowing sources. FHLB advances have traditionally been a significant borrowing source for the Bank.

Other sources of Core Banking income include service charges on deposit accounts, debit and credit card interchange fee income, title insurance commissions, fees charged to customers for trust services and revenue generated from Mortgage Banking activities. Mortgage Banking activities represent both the origination and sale of loans in the secondary market and the servicing of loans for others, primarily the Federal Home Loan Mortgage Corporation ( Freddie Mac or FHLMC ).

Core Banking operating expenses consist primarily of salaries and employee benefits, occupancy and equipment expenses, communication and transportation costs, data processing, debit card interchange expenses, marketing and development expenses, FDIC insurance expense, and various general and administrative costs. Core Banking results of operations are significantly impacted by general economic and competitive conditions, particularly changes in market interest rates, government laws and policies and actions of regulatory agencies.

The Core Bank provides short-term, revolving credit facilities to mortgage bankers across the Nation through mortgage warehouse lines of credit. These credit facilities are secured by single family, first lien residential real estate loans. Outstanding balances on these credit facilities may be subject to significant fluctuations consistent with the overall market demand for mortgage loans.

The Core Bank began acquiring single family, first lien mortgage loans for investment through its Correspondent Lending division in May 2014. Correspondent Lending generally involves the Bank acquiring, primarily from its Mortgage Warehouse clients, closed loans that meet the Bank's specifications. Substantially all loans purchased through the Correspondent Lending channel are purchased at a premium. Premiums on loans held for investment acquired through the Correspondent Lending division are amortized into interest income on the level-yield method over the expected life of the loan. Loans acquired through the Correspondent Lending division generally reflect borrowers outside of the Bank's historical market footprint. As of September 30, 2014, a substantial majority of loans originated through the Company's Correspondent Lending division were secured by single family residences located in the state of California.

**Republic Processing Group**

All divisions of the RPG segment operate through the Bank. Nationally, RPG facilitates the receipt and payment of federal and state tax refunds under the TRS division, primarily through refund transfers ( RT's ). RTs are products whereby a tax refund is issued to the taxpayer after the Bank has received the refund from the federal or state government. There is no credit risk or borrowing cost associated with these products, because they are only delivered to the taxpayer upon receipt of the tax refund directly from the governmental paying authority. Fees earned on RTs, net of rebates, are the primary source of revenue for the TRS division and the RPG segment, and are reported as non-interest income under the line item Net refund transfer fees.



The TRS division historically originated and obtained a significant source of revenue from Refund Anticipation Loans ( RAL s), but terminated this product effective April 30, 2012. RALs were short-term consumer loans offered to taxpayers that were secured by the customer s anticipated tax refund, which represented the sole source of repayment. While RALs were terminated in 2012, TRS has received and expects to continue receiving recoveries from previously charged-off RALs.

The RPS division is an issuing bank offering general purpose reloadable prepaid debit cards through third party program managers.

The RCS division is piloting short-term consumer credit products.

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**Recently Issued Accounting Standards Updates ( ASU )**

**ASU 2014-14 Receivables Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure.**

The amendments in this ASU require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if: a) the loan has a government guarantee that is not separable from the loan before foreclosure; b) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; and c) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. The separate other receivable recognized upon foreclosure should be measured based on the amount of the loan balance (principal and interest) expected to be received from the guarantor. The amendments in this ASU are effective for the Company beginning January 1, 2015 and are not expected to have a material impact on the Company's financial statements.

**Reclassifications and recasts** Certain amounts presented in prior periods have been reclassified to conform to the current period presentation. These reclassifications had no impact on prior years' net income.

Table of Contents**2. INVESTMENT SECURITIES****Securities Available for Sale**

The gross amortized cost and fair value of securities available for sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

<b>September 30, 2014 (in thousands)</b>	<b>Gross Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
U.S. Treasury securities and U.S. Government agencies	\$ 149,709	\$ 257	\$ (75)	\$ 149,891
Private label mortgage backed security	4,158	1,179		5,337
Mortgage backed securities - residential	125,058	5,363	(156)	130,265
Collateralized mortgage obligations	150,355	1,167	(844)	150,678
Freddie Mac preferred stock		669		669
Mutual fund	1,000	10		1,010
Corporate bonds	15,012	112		15,124
<b>Total securities available for sale</b>	<b>\$ 445,292</b>	<b>\$ 8,757</b>	<b>\$ (1,075)</b>	<b>\$ 452,974</b>

  

<b>December 31, 2013 (in thousands)</b>	<b>Gross Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
U.S. Treasury securities and U.S. Government agencies	\$ 97,157	\$ 409	\$ (101)	\$ 97,465
Private label mortgage backed security	4,740	745		5,485
Mortgage backed securities - residential	146,087	4,288	(288)	150,087
Collateralized mortgage obligations	164,264	1,228	(1,546)	163,946
Mutual fund	1,000		(5)	995
Corporate bonds	15,015	50	(150)	14,915
<b>Total securities available for sale</b>	<b>\$ 428,263</b>	<b>\$ 6,720</b>	<b>\$ (2,090)</b>	<b>\$ 432,893</b>

**Securities Held to Maturity**

The carrying value, gross unrecognized gains and losses, and fair value of securities held to maturity were as follows:

<b>September 30, 2014 (in thousands)</b>	<b>Carrying Value</b>	<b>Gross Unrecognized Gains</b>	<b>Gross Unrecognized Losses</b>	<b>Fair Value</b>
U.S. Treasury securities and U.S. Government agencies	\$ 2,257	\$ 7	\$ (8)	\$ 2,256
Mortgage backed securities - residential	409	49		458
Collateralized mortgage obligations	39,581	379	(24)	39,936
Corporate bonds	5,000		(109)	4,891

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Total securities held to maturity	\$ 47,247	\$ 435	\$ (141)	\$ 47,541
<b>December 31, 2013 (in thousands)</b>	<b>Carrying Value</b>	<b>Gross Unrecognized Gains</b>	<b>Gross Unrecognized Losses</b>	<b>Fair Value</b>
U.S. Treasury securities and U.S. Government agencies	\$ 2,311	\$ 7	\$ (13)	\$ 2,305
Mortgage backed securities - residential	420	43		463
Collateralized mortgage obligations	42,913	387	(184)	43,116
Corporate bonds	5,000		(116)	4,884
Total securities held to maturity	\$ 50,644	\$ 437	\$ (313)	\$ 50,768

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At September 30, 2014 and December 31, 2013, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity.

Sales of Securities Available for Sale

During the three and nine months ended September 30, 2014 and 2013, there were no sales or calls of securities available for sale or applicable income tax provisions for such transactions.

Investment Securities by Contractual Maturity

The amortized cost and fair value of the investment securities portfolio by contractual maturity at September 30, 2014 follows. Expected maturities may differ from contractual maturities if securities issuers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are detailed separately.

September 30, 2014 (in thousands)	Securities available for sale		Securities held to maturity	
	Amortized Cost	Fair Value	Carrying Value	Fair Value
Due in one year or less	\$ 23,543	\$ 23,676	\$ 496	\$ 496
Due from one year to five years	131,178	131,283	1,761	1,760
Due from five years to ten years	10,000	10,056	5,000	4,891
Due beyond ten years				
Private label mortgage backed security	4,158	5,337		
Mortgage backed securities - residential	125,058	130,265	409	458
Collateralized mortgage obligations	150,355	150,678	39,581	39,936
Freddie Mac preferred stock		669		
Mutual fund	1,000	1,010		
Total securities	\$ 445,292	\$ 452,974	\$ 47,247	\$ 47,541

Freddie Mac Preferred Stock

During 2008, the U.S. Treasury, the Federal Reserve Board, and the Federal Housing Finance Agency ( FHFA ) announced that the FHFA was placing Freddie Mac under conservatorship and giving management control to the FHFA. The Bank contemporaneously determined that its 40,000 shares of Freddie Mac preferred stock were fully impaired and recorded an Other Than Temporary Impairment ( OTTI ) charge of \$2.1 million for the shares. The OTTI charge brought the carrying value of the stock to \$0. During the second quarter of 2014, based on active trading volume of Freddie Mac preferred stock, the Company determined it appropriate to record an unrealized gain to other comprehensive income ( OCI ) related to its Freddie Mac preferred stock holdings. Based on the stock's market closing price as of September 30, 2014, the Company's unrealized gain for its Freddie Mac preferred stock totaled \$669,000. In October 2014, the unrealized gain in the Company's Freddie Mac preferred stock fell to approximately \$300,000 following a legal decision unfavorable to private investors in such stock.

**Corporate Bonds**

During 2013, the Bank purchased \$20 million in floating rate corporate bonds with an initial weighted average yield of 1.36%. The bonds, which have a weighted average life of seven years, were rated investment grade by accredited rating agencies as of their respective purchase dates. The total fair value of the Bank's corporate bonds represented 4% of the Bank's investment portfolio as of both September 30, 2014 and December 31, 2013.

**Mortgage Backed Securities**

At September 30, 2014, with the exception of the \$5.3 million private label mortgage backed security, all other mortgage backed securities held by the Bank were issued by U.S. government-sponsored entities and agencies, primarily Freddie Mac and the Federal National Mortgage Association ( Fannie Mae or FNMA ), institutions that the government has affirmed its commitment to support. At September 30, 2014 and December 31, 2013, there were gross unrealized/unrecognized losses of \$1.0 million and \$1.8 million related to available for sale mortgage backed securities. Because the decline in fair value of

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these mortgage backed securities is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Bank does not have the intent to sell these mortgage backed securities, and it is likely that it will not be required to sell the securities before their anticipated recovery, management does not consider these securities to be other-than-temporarily impaired.

Market Loss Analysis

Securities with unrealized losses at September 30, 2014 and December 31, 2013, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

September 30, 2014 (in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. Treasury securities and U.S. Government agencies	\$ 57,722	\$ (75)	\$	\$	\$ 57,722	\$ (75)
Mortgage backed securities - residential	7,795	(156)			7,795	(156)
Collateralized mortgage obligations	54,539	(660)	6,837	(184)	61,376	(844)
Total securities available for sale	\$ 120,056	\$ (891)	\$ 6,837	\$ (184)	\$ 126,893	\$ (1,075)

December 31, 2013 (in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities held to maturity:						
U.S. Treasury securities and U.S. Government agencies	\$ 519	\$ (8)	\$	\$	\$ 519	\$ (8)
Collateralized mortgage obligations	9,205	(24)			9,205	(24)
Corporate bonds	4,891	(109)			4,891	(109)
Total securities held to maturity	\$ 14,615	\$ (141)	\$	\$	\$ 14,615	\$ (141)

September 30, 2014 (in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. Treasury securities and U.S. Government agencies	\$ 44,041	\$ (101)	\$	\$	\$ 44,041	\$ (101)
Mortgage backed securities - residential	19,494	(288)			19,494	(288)
Collateralized mortgage obligations	55,927	(1,546)			55,927	(1,546)
Mutual fund	995	(5)			995	(5)
Corporate bonds	9,850	(150)			9,850	(150)
Total securities available for sale	\$ 130,307	\$ (2,090)	\$	\$	\$ 130,307	\$ (2,090)

December 31, 2013 (in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities held to maturity:						

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U.S. Treasury securities and U.S. Government agencies	\$	521	\$	(13)	\$	\$	521	\$	(13)
Collateralized mortgage obligations		18,686		(184)			18,686		(184)
Corporate bonds		4,884		(116)			4,884		(116)
Total securities held to maturity	\$	24,091	\$	(313)	\$	\$	24,091	\$	(313)



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At September 30, 2014, the Bank's security portfolio consisted of 161 securities, 23 of which were in an unrealized loss position. At December 31, 2013, the Bank's security portfolio consisted of 162 securities, 27 of which were in an unrealized loss position.

**Other-than-temporary Impairment**

Unrealized losses for all investment securities are reviewed to determine whether the losses are other-than-temporary. Investment securities are evaluated for OTTI on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in value below amortized cost is other-than-temporary. In conducting this assessment, the Bank evaluates a number of factors including, but not limited to:

- The length of time and the extent to which fair value has been less than the amortized cost basis;
- The Bank's intent to hold until maturity or sell the debt security prior to maturity;
- An analysis of whether it is more likely than not that the Bank will be required to sell the debt security before its anticipated recovery;
- Adverse conditions specifically related to the security, an industry, or a geographic area;
- The historical and implied volatility of the fair value of the security;
- The payment structure of the security and the likelihood of the issuer being able to make payments;
- Failure of the issuer to make scheduled interest or principal payments;
- Any rating change by a rating agency; and
- Recoveries or additional decline in fair value subsequent to the balance sheet date.

The term other-than-temporary is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized for the anticipated credit losses.

The Bank owns one private label mortgage backed security with a total carrying value of \$5.3 million at September 30, 2014. This security, with an average remaining life currently estimated at three years, is mostly backed by Alternative A first lien mortgage loans, but also has an insurance wrap or guarantee as an added layer of protection to the security holder. This asset is illiquid, and as such, the Bank determined it to be a Level 3 security in accordance with Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements and Disclosures*. Based on this determination, the Bank utilized an income valuation model (present value model) approach, in determining the fair value of the security. This approach is beneficial for positions that are not traded in active markets or are subject to transfer restrictions, and/or where valuations are

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adjusted to reflect illiquidity and/or non-transferability. Such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support for this investment.

*See additional discussion regarding the Bank's private label mortgage backed security under Footnote 6 Fair Value in this section of the filing.*

### **Pledged Investment Securities**

Investment securities pledged to secure public deposits, securities sold under agreements to repurchase and securities held for other purposes, as required or permitted by law are as follows:

(in thousands)	September 30, 2014	December 31, 2013
Carrying amount	\$ 328,463	\$ 224,693
Fair value	328,763	224,989

Table of Contents**3. LOANS AND ALLOWANCE FOR LOAN LOSSES**

The Bank's financing receivables consist primarily of loans and a minimal amount of lease financing receivables (together referred to as loans). Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, inclusive of purchase premiums or discounts, deferred loan fees and costs and the allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method.

Lease financing receivables, all of which are direct financing leases, are reported at their principal balance outstanding net of any unearned income, deferred fees and costs and applicable allowance for losses. Leasing income is recognized on a basis that achieves a constant periodic rate of return on the outstanding lease financing balances over the lease terms.

The composition of loans follows:

(in thousands)	September 30, 2014	December 31, 2013
Residential real estate:		
Owner occupied	\$ 1,127,595	\$ 1,097,795
Owner occupied - correspondent*	139,252	
Non owner occupied	98,365	110,809
Commercial real estate	771,765	773,173
Commercial real estate - purchased whole loans*	34,714	34,186
Construction & land development	44,462	44,351
Commercial & industrial	149,943	127,763
Lease financing receivables	819	
Warehouse lines of credit	272,584	149,576
Home equity	241,189	226,782
Consumer:		
RPG loans	3,460	1,827
Credit cards	9,230	9,030
Overdrafts	966	944
Purchased whole loans*	4,664	
Other consumer	9,527	13,556
<b>Total loans**</b>	<b>2,908,535</b>	<b>2,589,792</b>
Allowance for loan losses	(23,617)	(23,026)
<b>Total loans, net</b>	<b>\$ 2,884,918</b>	<b>\$ 2,566,766</b>

\* - Identifies loans outside of the Bank's historical market footprint.

\*\* - Total loans are presented inclusive of premiums, discounts and net loan origination fees and costs. See table directly below for expanded detail.

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The table below reconciles the contractually receivable and carrying amounts of loans at September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014		December 31, 2013	
Contractually receivable	\$	2,922,238	\$	2,614,632
Unearned income		(95)		
Unamortized premiums(1)		3,032		260
Unaccreted discounts(2)		(18,089)		(26,624)
Net unamortized deferred origination fees and costs		1,449		1,524
Carrying value of loans	\$	2,908,535	\$	2,589,792

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(1) - Premiums predominately relate to loans acquired through the Bank's Correspondent Lending division.

(2) - Discounts predominately relate to loans acquired in the Bank's 2012 FDIC-assisted transactions.

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In May 2014, the Bank began acquiring single family, first lien mortgage loans for investment within its loan portfolio through its Correspondent Lending division. Correspondent Lending generally involves the Bank acquiring, primarily from its Mortgage Warehouse clients, closed loans that meet the Bank's specifications. Substantially all loans purchased through the Correspondent Lending channel are purchased at a premium. Premiums on loans held for investment acquired through the Correspondent Lending division are amortized into interest income on a level-yield method over the expected life of the loan. Loans acquired through the Correspondent Lending division generally reflect borrowers outside of the Bank's historical market footprint, with a substantial majority of loans originated through the division as of September 30, 2014, secured by single residences located in the state of California.

In addition to secured mortgage loans acquired through its Correspondent Lending division, the Bank also began acquiring unsecured consumer installment loans for investment from a third-party originator in April 2014. Such consumer loans are purchased at par and are selected by the Bank based on certain underwriting characteristics.

The table below reflects the purchased activity of single family, first lien mortgage loans and unsecured consumer loans, by class, during the three and nine months ended September 30, 2014. No purchases of these type loans were made during 2013.

(in thousands)	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Residential real estate:		
Owner occupied - correspondent	\$ 128,374	\$ 139,632
Consumer:		
Purchased whole loans	2,524	5,037
Total purchased loans	\$ 130,898	\$ 144,669

Table of Contents**Purchased Credit Impaired ( PCI ) Loans**

The contractual amount of PCI loans acquired during the Bank's 2012 FDIC-assisted transactions and accounted for under ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, decreased from \$58 million as of December 31, 2013 to \$36 million as of September 30, 2014. The carrying value of these loans was \$41 million as of December 31, 2013 compared to \$25 million as of September 30, 2014.

The table below reconciles the contractually required and carrying amounts of PCI loans at September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014		December 31, 2013	
Contractually-required principal	\$	35,760	\$	57,992
Non-accretable amount		(8,610)		(13,582)
Accretable amount		(2,418)		(3,457)
Carrying value of loans	\$	24,732	\$	40,953

The following table presents a rollforward of the accretable amount on PCI loans for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	\$ (2,487)	\$ (1,381)	\$ (3,457)	\$ (3,231)
Transfers between non-accretable and accretable	(609)	(3,725)	(2,949)	(5,421)
Net accretion into interest income on loans, including loan fees	678	1,916	3,988	5,179
Other changes				283
Balance, end of period	\$ (2,418)	\$ (3,190)	\$ (2,418)	\$ (3,190)

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Based on the Bank's internal analyses performed as of September 30, 2014 and December 31, 2013, the following tables reflect loans by risk category, as such categories are defined in the Company's Annual Report on Form 10-K for the year ended December 31, 2013:

September 30, 2014 (in thousands)	Pass	Special Mention *	Substandard *	Doubtful / Loss	Purchased Credit Impaired Loans - Group 1	Purchased Credit Impaired Loans - Substandard	Total Rated Loans**
Residential real estate:							
Owner occupied	\$	\$ 27,485	\$ 12,845	\$	\$ 1,612	\$	\$ 41,942
Owner occupied - correspondent							
Non owner occupied		1,173	2,329		3,988		7,490
Commercial real estate	729,403	9,549	15,794		16,978	41	771,765
Commercial real estate - purchased whole loans							
	34,714						34,714
Construction & land development							
	41,248	122	2,462		630		44,462
Commercial & industrial	146,183	493	1,803		1,253	211	149,943
Lease financing receivables	819						819
Warehouse lines of credit	272,584						272,584
Home equity			2,230				2,230
Consumer:							
RPG loans							
Credit cards							
Overdrafts							
Purchased whole loans							
Other consumer		14	48		19		81
<b>Total</b>	<b>\$ 1,224,951</b>	<b>\$ 38,836</b>	<b>\$ 37,511</b>	<b>\$</b>	<b>\$ 24,480</b>	<b>\$ 252</b>	<b>\$ 1,326,030</b>

\* - At September 30, 2014, Special Mention and Substandard loans included \$1 million and \$5 million, respectively, which were removed from PCI accounting in accordance with ASC 310-30-35-13 due to a post-acquisition troubled debt restructuring.

\*\* - The above table excludes all non-classified residential real estate and consumer loans at the respective period ends. The table also excludes most non-classified small commercial & industrial and commercial real estate relationships totaling \$100,000 or less. These loans are not rated by the Company since they are accruing interest and are not past due 80-days-or-more.

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December 31, 2013 (in thousands)	Pass	Special Mention *	Substandard *	Doubtful / Loss	Purchased Credit Impaired Loans - Group 1	Purchased Credit Impaired Loans - Substandard	Total Rated Loans**
<b>Residential real estate:</b>							
Owner occupied	\$	\$ 27,431	\$ 10,994	\$	\$ 2,810	\$	\$ 41,235
Owner occupied - correspondent							
Non owner occupied		919	1,292		7,936		10,147
Commercial real estate	709,610	11,125	25,296		27,142		773,173
Commercial real estate - Purchased whole loans	34,186						34,186
Construction & land development	40,591	128	2,386		1,246		44,351
Commercial & industrial	123,646	296	2,035		1,564	222	127,763
Lease financing receivables							
Warehouse lines of credit	149,576						149,576
Home equity		250	2,014				2,264
<b>Consumer:</b>							
RPG loans							
Credit cards							
Overdrafts							
Purchased whole loans							
Other consumer		18	66		33		117
<b>Total</b>	<b>\$ 1,057,609</b>	<b>\$ 40,167</b>	<b>\$ 44,083</b>	<b>\$</b>	<b>\$ 40,731</b>	<b>\$ 222</b>	<b>\$ 1,182,812</b>

\* - At December 31, 2013, Special Mention and Substandard loans included \$1 million and \$6 million, respectively, which were removed from PCI accounting in accordance with ASC 310-30-35-13 due to a post-acquisition troubled debt restructuring.

\*\* - The above table excludes all non-classified residential real estate and consumer loans at the respective period ends. The table also excludes most non-classified small commercial & industrial and commercial real estate relationships totaling \$100,000 or less. These loans are not rated by the Company since they are accruing interest and are not past due 80-days-or-more.



Table of Contents**Allowance for Loan Losses**

Activity in the allowance for loan losses ( Allowance ) follows:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Allowance, beginning of period	\$ 22,772	\$ 22,491	\$ 23,026	\$ 23,729
Charge offs - Traditional Banking	(1,071)	(1,627)	(2,698)	(4,744)
Charge offs - RPG	(2)		(2)	
Total charge offs	(1,073)	(1,627)	(2,700)	(4,744)
Recoveries - Traditional Banking	376	371	1,233	1,231
Recoveries - RPG	32	57	558	796
Total recoveries	408	428	1,791	2,027
Net (charge offs) recoveries - Traditional Banking	(695)	(1,256)	(1,465)	(3,513)
Net (charge offs) recoveries - RPG	30	57	556	796
Net (charge offs) recoveries	(665)	(1,199)	(909)	(2,717)
Provision for losses - Traditional Banking	1,542	2,257	2,012	3,276
Provision for losses - RPG	(32)	(57)	(512)	(796)
Total provision for losses	1,510	2,200	1,500	2,480
Allowance, end of period	\$ 23,617	\$ 23,492	\$ 23,617	\$ 23,492

The Allowance calculation includes the following qualitative factors, which are considered in combination with the Bank's historical loss rates in determining the general loss reserve within the Allowance:

- Changes in nature, volume and seasoning of the portfolio;
- Changes in experience, ability and depth of lending management and other relevant staff;
- Changes in the quality of the Bank's credit review system;
- Changes in policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses;
- Changes in the volume and severity of past due, non-accrual and classified loans;
- Changes in the value of underlying collateral for collateral-dependent loans;

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- Changes in international, national, regional, and local economic and business conditions and developments that affect the collectibility of portfolios, including the condition of various market segments;
- The existence and effect of any concentrations of credit, and changes in the level of such concentrations; and
- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution's existing portfolio.

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The following tables present the activity in the Allowance by portfolio class for the three months ended September 30, 2014 and 2013:

Three Months Ended September 30, 2014 (in thousands)	Residential Real Estate			Commercial Real Estate -			Lease	
	Owner Occupied	Owner Occupied - Correspondent	Non Owner Occupied	Commercial Real Estate	Purchased Whole Loans	Construction & Land Development	Commercial & Financing Receivables	
Beginning balance	\$ 8,055	\$ 60	\$ 839	\$ 7,696	\$ 34	\$ 1,090	\$ 1,152	3
Provision for losses	(148)	706	50	547		(4)	(81)	5
Charge offs	(161)		(135)	(365)				