

REPUBLIC FIRST BANCORP INC
Form 10-Q
August 12, 2013

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

FORM 10-Q

- Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2013.
or
 Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ____ to ____.

Commission File Number: 000-17007

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

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

50 South 16th Street, 19102
Philadelphia, Pennsylvania
(Address of principal executive (Zip code)
offices)

215-735-4422
(Registrant's telephone number, including area code)
Not Applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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
(Do not check if a smaller reporting company)

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

YES NO

APPLICABLE ONLY TO CORPORATE ISSUERS

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

Common Stock, par value \$0.01 per share	25,972,897
Title of Class	Number of Shares Outstanding as of August 9, 2013

REPUBLIC FIRST BANCORP, INC. AND SUBSIDIARIES
TABLE OF CONTENTS

Part I: Financial Information	Page
Item 1.	<p style="margin-left: 40px;">Financial Statements</p> <p style="margin-left: 80px;">Consolidated balance sheets as of June 30, 2013 and December 31, 2012 (unaudited) <u>1</u></p> <p style="margin-left: 80px;">Consolidated statements of income for the three and six months ended June 30, 2013 and 2012 (unaudited) <u>2</u></p> <p style="margin-left: 80px;">Consolidated statements of comprehensive income (loss) for the three and six months ended June, 2013 and 2012 (unaudited) <u>3</u></p> <p style="margin-left: 80px;">Consolidated statements of cash flows for the six months ended June 30, 2013 and 2012 (unaudited) <u>4</u></p> <p style="margin-left: 80px;">Consolidated statements of changes in shareholders' equity for the six months ended June 30, 2013 and 2012 (unaudited) <u>5</u></p> <p style="margin-left: 80px;">Notes to consolidated financial statements (unaudited) <u>6</u></p>
Item 2.	<p style="margin-left: 40px;">Management's Discussion and Analysis of Financial Condition and Results of Operations <u>30</u></p>
Item 3.	<p style="margin-left: 40px;">Quantitative and Qualitative Disclosures about Market Risk <u>48</u></p>
Item 4.	<p style="margin-left: 40px;">Controls and Procedures <u>48</u></p>
Part II: Other Information	
Item 1.	<p style="margin-left: 40px;">Legal Proceedings <u>49</u></p>
Item 1A.	<p style="margin-left: 40px;">Risk Factors <u>49</u></p>
Item 2.	<p style="margin-left: 40px;">Unregistered Sales of Equity Securities and Use of Proceeds <u>49</u></p>
Item 3.	<p style="margin-left: 40px;">Defaults Upon Senior Securities <u>49</u></p>
Item 4.	<p style="margin-left: 40px;">Mine Safety Disclosures <u>49</u></p>
Item 5.	<p style="margin-left: 40px;">Other Information <u>49</u></p>
Item 6.	<p style="margin-left: 40px;">Exhibits <u>50</u></p>

Signatures

51



Republic First Bancorp, Inc. and Subsidiaries
Consolidated Balance Sheets
June 30, 2013 and December 31, 2012
(Dollars in thousands, except per share data)
(unaudited)

	June 30, 2013	December 31, 2012
ASSETS		
Cash and due from banks	\$ 8,934	\$ 9,097
Interest bearing deposits with banks	47,850	118,907
Cash and cash equivalents	56,784	128,004
Investment securities available for sale, at fair value	184,371	189,259
Investment securities held to maturity, at amortized cost (fair value of \$69 and \$69, respectively)	68	67
Restricted stock, at cost	2,326	3,816
Loans held for sale	282	82
Loans receivable (net of allowance for loan losses of \$9,332 and \$9,542, respectively)	628,401	608,359
Premises and equipment, net	21,232	21,976
Other real estate owned, net	6,584	8,912
Accrued interest receivable	2,969	3,128
Bank owned life insurance	-	10,490
Other assets	16,649	14,565
Total Assets	\$ 919,666	\$ 988,658
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Demand – non-interest bearing	\$ 143,485	\$ 145,407
Demand – interest bearing	180,802	180,440
Money market and savings	408,355	440,120
Time deposits	88,210	123,234
Total Deposits	820,852	889,201
Accrued interest payable	522	301
Other liabilities	6,448	6,778
Subordinated debt	22,476	22,476
Total Liabilities	850,298	918,756
Shareholders' Equity		
Preferred stock, par value \$0.01 per share: 10,000,000 shares authorized; no shares issued	-	-
Common stock, par value \$0.01 per share: 50,000,000 shares authorized; shares issued 26,501,742	265	265
Additional paid in capital	106,908	106,753
Accumulated deficit	(32,225)	(34,228)
Treasury stock at cost (416,303 shares)	(3,099)	(3,099)

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Stock held by deferred compensation plan	(809)	(809)
Accumulated other comprehensive income (loss)	(1,672)	1,020	
Total Shareholders' Equity	69,368		69,902	
Total Liabilities and Shareholders' Equity	\$ 919,666		\$ 988,658	

(See notes to consolidated financial statements)

Republic First Bancorp, Inc. and Subsidiaries
Consolidated Statements of Income
For the Three and Six Months Ended June 30, 2013 and 2012
(Dollars in thousands, except per share data)
(unaudited)

	Three Months Ended June		Six Months Ended June	
	2013	30, 2012	2013	30, 2012
Interest income:				
Interest and fees on taxable loans	\$7,991	\$8,114	\$15,828	\$16,134
Interest and fees on tax-exempt loans	89	65	180	135
Interest and dividends on taxable investment securities	1,043	1,269	2,090	2,538
Interest and dividends on tax-exempt investment securities	48	117	121	233
Interest on federal funds sold and other interest-earning assets	44	84	103	185
Total interest income	9,215	9,649	18,322	19,225
Interest expense:				
Demand- interest bearing	207	185	402	356
Money market and savings	428	722	930	1,585
Time deposits	204	433	483	1,014
Other borrowings	278	284	556	569
Total interest expense	1,117	1,624	2,371	3,524
Net interest income	8,098	8,025	15,951	15,701
Provision (credit) for loan losses	925	500	925	(250)
Net interest income after provision (credit) for loan losses	7,173	7,525	15,026	15,951
Non-interest income:				
Loan advisory and servicing fees	436	329	774	540
Gain on sales of SBA loans	2,107	1,110	2,757	2,196
Service fees on deposit accounts	265	226	499	436
Legal settlements	-	-	238	105
Gain on sale of investment securities	-	774	703	774
Other-than-temporary impairment losses	-	(16)	-	(33)
Portion recognized in other comprehensive income (before taxes)	-	2	-	2
Net impairment loss on investment securities	-	(14)	-	(31)
Bank owned life insurance income	-	16	13	35
Other non-interest income	62	58	129	90
Total non-interest income	2,870	2,499	5,113	4,145
Non-interest expenses:				
Salaries and employee benefits	4,503	3,963	8,790	8,097
Occupancy	876	872	1,720	1,716
Depreciation and amortization	472	506	955	1,024
Legal	503	898	867	1,787
Other real estate owned	109	104	1,026	202
Advertising	117	100	218	150
Data processing	307	311	415	575
Insurance	153	176	311	310

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Professional fees	359	298	682	591
Regulatory assessments and costs	241	351	585	689
Taxes, other	253	277	503	537
Other operating expenses	1,163	1,154	2,114	2,168
Total non-interest expense	9,056	9,010	18,186	17,846
Income before provision (benefit) for income taxes	987	1,014	1,953	2,250
Provision (benefit) for income taxes	(24)	7	(50)	(62)
Net income	\$1,011	\$1,007	\$2,003	\$2,312
Net income per share:				
Basic	\$0.04	\$0.04	\$0.08	\$0.09
Diluted	\$0.04	\$0.04	\$0.08	\$0.09

(See notes to consolidated financial statements)

Republic First Bancorp, Inc. and Subsidiaries
 Consolidated Statements of Comprehensive Income (Loss)
 For the Three and Six Months Ended June 30, 2013 and 2012
 (Dollars in thousands)
 (unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income	\$ 1,011	\$ 1,007	\$ 2,003	\$ 2,312
Other comprehensive income (loss), net of tax				
Unrealized gain (loss) on securities (pre-tax \$(3,504), \$376, \$(3,498), and \$605, respectively)	(2,246)	241	(2,242)	388
Reclassification adjustment for securities gains (pre-tax \$-, \$774, \$703, and \$774, respectively)	-	(503)	(450)	(503)
Reclassification adjustment for impairment charge (pre-tax \$-, \$14, \$-, and \$31, respectively)	-	9	-	20
Total other comprehensive loss	(2,246)	(253)	(2,692)	(95)
Total comprehensive income (loss)	\$ (1,235)	\$ 754	\$ (689)	\$ 2,217

(See notes to consolidated financial statements)

Republic First Bancorp, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
For the Six Months Ended June 30, 2013 and 2012
(Dollars in thousands)
(unaudited)

	Six Months Ended June 30,	
	2013	2012
Cash flows from operating activities		
Net income	\$2,003	\$2,312
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (credit) for loan losses	925	(250)
(Gain) loss on sale of other real estate owned	(229)	10
Write down of other real estate owned	809	-
Depreciation and amortization	955	1,024
Stock based compensation	155	192
Gain on sale and call of investment securities	(703)	(774)
Impairment charges on investment securities	-	31
Amortization of premiums on investment securities	380	160
Proceeds from sales of SBA loans originated for sale	27,410	23,066
SBA loans originated for sale	(24,853)	(20,920)
Gains on sales of SBA loans originated for sale	(2,757)	(2,196)
Increase in value of bank owned life insurance	(13)	(35)
Increase in accrued interest receivable and other assets	(416)	(823)
Decrease in accrued interest payable and other liabilities	(109)	(74)
Net cash provided by operating activities	3,557	1,723
Cash flows from investing activities		
Purchase of investment securities available for sale	(25,289)	(40,902)
Proceeds from the sale of securities available for sale	7,946	22,590
Proceeds from the maturity or call of securities available for sale	18,352	13,265
Proceeds from the maturity or call of securities held to maturity	-	74
Proceeds from redemption of FHLB stock	1,490	505
Net increase in loans	(21,213)	(17,836)
Net proceeds from sale of other real estate owned	1,994	334
Surrender proceeds on bank owned life insurance	10,503	-
Premises and equipment expenditures	(211)	(289)
Net cash used in investing activities	(6,428)	(22,259)
Cash flows from financing activities		
Net decrease in demand, money market and savings deposits	(33,325)	(40,072)
Net decrease in time deposits	(35,024)	(71,225)
Net cash used in financing activities	(68,349)	(111,297)
Net decrease in cash and cash equivalents	(71,220)	(131,833)
Cash and cash equivalents, beginning of year	128,004	230,955
Cash and cash equivalents, end of period	\$56,784	\$99,122

Supplemental disclosures:

Interest paid	\$2,150	\$3,820
Income taxes paid	\$175	\$-
Non-cash transfers from loans to other real estate owned	\$246	\$-

(See notes to consolidated financial statements)

Republic First Bancorp, Inc. and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
For the Six Months Ended June 30, 2013 and 2012
(Dollars in thousands)
(unaudited)

	Common Stock	Additional Paid in Capital	Accumulated Deficit	Treasury Stock	Stock Held by Deferred Compensation Plan	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance January 1, 2013	\$ 265	\$ 106,753	\$ (34,228)	\$ (3,099)	\$ (809)	\$ 1,020	\$ 69,902
Net income			2,003				2,003
Other comprehensive loss, net of tax						(2,692)	(2,692)
Stock based compensation		155					155
Balance June 30, 2013	\$ 265	\$ 106,908	\$ (32,225)	\$ (3,099)	\$ (809)	\$ (1,672)	\$ 69,368
Balance January 1, 2012	\$ 265	\$ 106,383	\$ (37,842)	\$ (3,099)	\$ (809)	\$ (47)	\$ 64,851
Net income			2,312				2,312
Other comprehensive loss, net of tax						(95)	(95)
Stock based compensation		192					192
Balance June 30, 2012	\$ 265	\$ 106,575	\$ (35,530)	\$ (3,099)	\$ (809)	\$ (142)	\$ 67,260

(See notes to consolidated financial statements)

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

Note 1: Basis of Presentation

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

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

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

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

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. GAAP for interim financial information and with the instructions to United States Securities and Exchange Commission (“SEC”) Form 10-Q and Article 10 of SEC Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for financial statements for a complete fiscal year. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. All significant inter-company accounts and transactions have been eliminated in the consolidated financial statements. The Company has evaluated subsequent events through the date of issuance of the financial data included herein.

Note 2: Summary of Significant Accounting Policies

Risks and Uncertainties

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

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

Use of Estimates

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

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

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

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

In evaluating the Company’s ability to recover deferred tax assets, management considers all available positive and negative evidence. Management also makes assumptions on the amount of future taxable income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require management to make judgments that are consistent with the plans and estimates used to manage the Company’s business. As a result of cumulative losses in the years 2008 through 2011 and the uncertain nature of the current economic environment, the Company has decided to currently exclude future taxable income from its analysis on the ability to recover deferred tax assets and has recorded a valuation allowance against its deferred tax assets. An increase or decrease in the valuation allowance would result in an adjustment to income tax expense in the period and could have a significant impact on the Company’s future earnings.

Stock-Based Compensation

The Company has a Stock Option and Restricted Stock Plan (“Plan”), under which the Company may grant options, restricted stock or stock appreciation rights to the Company’s employees, directors, and certain consultants. Under the terms of the Plan, 1.5 million shares of common stock, plus an annual increase equal to the number of shares needed to restore the maximum number of shares that may be available for grant under the Plan to 1.5 million shares, are

available for such grants. As of June 30, 2013, the only grants under the Plan have been option grants. The Plan provides that the exercise price of each option granted equals the market price of the Company's stock on the date of the grant. Any option granted vests within one to five years and has a maximum term of ten years.

The Company utilizes the Black-Scholes option pricing model to calculate the estimated fair value of each stock option granted on the date of the grant. A summary of the assumptions used in the Black-Scholes option pricing model for 2013 and 2012 are as follows:

	2013		2012	
Dividend yield(1)	0.0	%	0.0	%
Expected volatility(2)	54.88% to 55.08%		53.12% to 54.21%	
Risk-free interest rate(3)	1.28% to 2.02%		1.01% to 1.61%	
Expected life(4)	7.0 years		7.0 years	

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

(2) Expected volatility is based on Bloomberg's seven year volatility calculation for "FRBK" stock.

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

(4) The expected life reflects a 3 to 4 year vesting period, the maximum ten year term and review of historical behavior.

During the six months ended June 30, 2013 and 2012, 109,787 options and 21,000 options vested, respectively. Expense is recognized ratably over the period required to vest. At June 30, 2013, the intrinsic value of the 1,200,280 options outstanding was \$344,580, while the intrinsic value of the 288,717 exercisable (vested) options was \$38,036. During the six months ended June 30, 2013, 83,500 options were forfeited with a weighted average grant date fair value of \$289,015.

Information regarding stock based compensation for the six months ended June 30, 2013 and 2012 is set forth below:

	2013		2012	
Stock based compensation expense recognized	\$	155,000	\$	192,000
Number of unvested stock options		911,563		845,600
Fair value of unvested stock options	\$	1,245,470	\$	1,562,250
Amount remaining to be recognized as expense	\$	687,636	\$	638,125

The remaining amount of \$687,636 will be recognized as expense through June 2017.

Earnings per Share

Earnings per share ("EPS") consist of two separate components: basic EPS and diluted EPS. Basic EPS is computed by dividing net income by the weighted average number of common shares outstanding for each period presented. Diluted EPS is calculated by dividing net income by the weighted average number of common shares outstanding plus dilutive common stock equivalents ("CSEs"). CSEs consist of dilutive stock options granted through the Company's Plan and convertible securities related to the trust preferred securities issued in 2008. In the diluted EPS computation, the after tax interest expense on the trust preferred securities issuance is added back to the net income. For the three and six months ended June 30, 2013 and 2012, the effect of CSEs (convertible securities related to the trust preferred securities only) and the related add back of after tax interest expense was considered anti-dilutive and therefore was not included in the EPS calculation.

The calculation of EPS for the three and six months ended June, 2013 and 2012 is as follows (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income (basic and diluted)	\$1,011	\$ 1,007	\$2,003	\$ 2,312
Weighted average shares outstanding	25,973	25,973	25,973	25,973
Net income per share – basic	\$0.04	\$ 0.04	\$0.08	\$ 0.09
Weighted average shares outstanding (including dilutive CSEs)	26,103	25,996	26,062	25,988
Net income per share – diluted	\$0.04	\$ 0.04	\$0.08	\$ 0.09

Recent Accounting Pronouncements

ASU 2013-02

In February 2013, the FASB issued ASU 2013-02, “Reporting of Amounts Reclassified Out of Comprehensive Income.” The amendments in this ASU are intended to improve the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required that provide additional detail about those amounts. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is reclassified to a balance sheet account instead of directly to income or expense in the same reporting period. The ASU was effective for public entities for reporting periods beginning after December 15, 2012 and did not have a material impact on the Company’s financial statements.

Note 3: Legal Proceedings

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

Note 4: Segment Reporting

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

Note 5: Investment Securities

A summary of the amortized cost and market value of securities available for sale and securities held to maturity at June 30, 2013 and December 31, 2012 is as follows:

(dollars in thousands)	At June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Collateralized mortgage obligations	\$ 106,473	\$ 588	\$ (2,293)	\$ 104,768
Mortgage-backed securities	17,647	718	(60)	18,305
Municipal securities	5,360	97	(97)	5,360
Corporate bonds	32,203	773	-	32,976
Asset-backed securities	19,416	268	-	19,684
Trust preferred securities	5,766	-	(2,604)	3,162
Other securities	115	1	-	116
Total securities available for sale	\$ 186,980	\$ 2,445	\$ (5,054)	\$ 184,371
U.S. Government agencies	\$ 1	\$ -	\$ -	\$ 1
Other securities	67	1	-	68
Total securities held to maturity	\$ 68	\$ 1	\$ -	\$ 69

(dollars in thousands)	At December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Collateralized mortgage obligations	\$ 97,959	\$ 1,830	\$ (6)	\$ 99,783
Mortgage-backed securities	20,626	1,014	-	21,640
Municipal securities	11,150	967	(16)	12,101
Corporate bonds	32,231	639	(185)	32,685
Asset-backed securities	19,785	135	(191)	19,729
Trust preferred securities	5,785	-	(2,598)	3,187
Other securities	131	3	-	134
Total securities available for sale	\$ 187,667	\$ 4,588	\$ (2,996)	\$ 189,259
U.S. Government agencies	\$ 1	\$ -	\$ -	\$ 1
Other securities	66	2	-	68
Total securities held to maturity	\$ 67	\$ 2	\$ -	\$ 69

The maturity distribution of the amortized cost and estimated market value of investment securities by contractual maturity at June 30, 2013 is as follows:

(dollars in thousands)	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in 1 year or less	\$ 16,175	\$ 16,516	\$ 47	\$ 48

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After 1 year to 5 years	72,281	72,383	21	21
After 5 years to 10 years	91,165	87,946	-	-
After 10 years	7,359	7,526	-	-
Total	\$ 186,980	\$ 184,371	\$ 68	\$ 69

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

As of June 30, 2013 and December 31, 2012, the collateralized mortgage obligations and mortgage backed securities included in the investment securities portfolio consist solely of securities issued by U.S. government sponsored agencies. There were no private label mortgage securities held in the investment securities portfolio as of those dates. The Company did not hold any mortgage-backed securities that were rated "Alt-A" or "Subprime" as of June 30, 2013 and December 31, 2012. In addition, the Company did not hold any private issued CMO's as of June 30, 2013 and December 31, 2012. As of June 30, 2013 and December 31, 2012, the asset-backed securities consisted solely of Sallie Mae bonds collateralized by student loans which are guaranteed by the U.S. Department of Education.

In instances when a determination is made that an other-than-temporary impairment exists with respect to a debt security but the investor does not intend to sell the debt security and it is more likely than not that the investor will not be required to sell the debt security prior to its anticipated recovery, accounting standards require the other-than-temporary impairment to be separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income. There were no impairment charges (credit losses) on trust preferred securities for the three and six months ended June 30, 2013. Impairment charges (credit losses) on trust preferred securities for the three and six months ended June 30, 2012 amounted to \$14,000 and \$31,000, respectively.

The following table presents a roll-forward of the balance of credit-related impairment losses on securities held at June 30, 2013 and 2012 for which a portion of OTTI was recognized in other comprehensive income:

(dollars in thousands)	2013	June 30, 2012
Beginning Balance, January 1st	\$3,959	\$3,925
Additional credit-related impairment loss on securities for which an other-than-temporary impairment was previously recognized	-	31
Reductions for securities paid off during the period	-	-
Reductions for securities for which the amount previously recognized in other comprehensive income was recognized in earnings because the Company intends to sell the security	-	-
Ending Balance, June 30th	\$3,959	\$3,956

The Company realized gross gains on the sale of securities of \$703,000 during the six months ended June 30, 2013. The related sale proceeds amounted to \$7.9 million. The tax provision applicable to these gross gains in 2013 amounted to approximately \$253,000. The Company realized gross gains on the sale of securities of \$774,000 during the three and six months ended June 30, 2012. The related sale proceeds amounted to \$22.6 million. The tax provision applicable to these gross gains in 2012 amounted to approximately \$271,000.

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

(dollars in thousands)	At June 30, 2013					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Collateralized mortgage obligations	\$ 70,117	\$ 2,293	\$ -	\$ -	\$ 70,117	\$ 2,293
Mortgage-backed securities	1,178	60	-	-	1,178	60
Municipal securities	1,328	97	-	-	1,328	97
Corporate bonds	-	-	-	-	-	-
Trust preferred securities	-	-	3,162	2,604	3,162	2,604
Total	\$ 72,623	\$ 2,450	\$ 3,162	\$ 2,604	\$ 75,785	\$ 5,054

(dollars in thousands)	At December 31, 2012					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Collateralized mortgage obligations	\$ 9,991	\$ 6	\$ -	\$ -	\$ 9,991	\$ 6
Municipal securities	1,050	16	-	-	1,050	16
Corporate bonds	-	-	9,811	185	9,811	185
Asset-backed securities	9,218	191	-	-	9,218	191
Trust preferred securities	-	-	3,187	2,598	3,187	2,598
Total	\$ 20,259	\$ 213	\$ 12,998	\$ 2,783	\$ 33,257	\$ 2,996

The impairment of the investment portfolio totaled \$5.1 million with a total fair value of \$75.8 million at June 30, 2013. The most significant component of this impairment is related to the trust preferred securities held in the portfolio. Unrealized losses on the trust preferred securities amount to \$2.6 million at June 30, 2013. The unrealized losses associated with the trust preferred securities are a result of the secondary market for such securities becoming inactive and are considered temporary at this time.

The following table provides additional detail about trust preferred securities as of June 30, 2013.

(dollars in thousands)	Class / Tranche	Amortized Cost	Fair Value	Unrealized Losses	Lowest Credit Rating Assigned	Number of Banks Currently Performing	Deferrals Conditional / Default Rates		Cumulative OTTI Life to Date
							Number of Current	Rates for 2013 and beyond	
Preferred Term Securities IV	Mezzanine Notes	\$ 49	\$ 40	\$ (9)	CCC	5	27 %	0.32 %	\$ -
	Mezzanine	1,478	1,071	(407)	C	13	46	0.33	2,173

Preferred Term Securities VII	Notes									
TPREF Funding II	Class B Notes	739	336	(403)	C	16	44	0.38	260	
TPREF Funding III	Class B2 Notes	1,520	724	(796)	C	17	35	0.32	480	
Trapeza CDO I, LLC	Class C1 Notes	556	245	(311)	C	9	49	0.39	470	
ALESCO Preferred Funding IV	Class B1 Notes	604	326	(278)	C	38	14	0.36	396	
ALESCO Preferred Funding V	Class C1 Notes	820	420	(400)	C	37	24	0.35	180	
Total		\$ 5,766	3,162	\$ (2,604)		135	33 %		\$ 3,959	

At June 30, 2013, the investment portfolio included eight municipal securities with a total market value of \$5.4 million. One of these securities carried an unrealized loss at June 30, 2013. Each of the municipal securities is reviewed quarterly for impairment. Research on each issuer is completed to ensure the financial stability of the municipal entity. The largest geographic concentration was in Pennsylvania where one municipal security had a market value of \$1.3 million. As of June 30, 2013, management found no evidence of OTTI on any of the municipal securities held in the investment securities portfolio.

At June 30, 2013, the investment portfolio included eighteen collateralized mortgage obligations with a total market value of \$104.8 million. Thirteen of these securities carried an unrealized loss at June 30, 2013. At June 30, 2013, the investment portfolio included forty-two mortgage-backed securities with a total market value of \$18.3 million. One of these securities carried an unrealized loss at June 30, 2013. Management found no evidence of OTTI on any of these securities and the unrealized losses are due to changes in market value resulting from changes in market interest rates and are considered temporary as of June 30, 2013.

Note 6: Loans Receivable and Allowance for Loan Losses

The following table sets forth the Company's gross loans by major categories as of June 30, 2013, and December 31, 2012:

(dollars in thousands)	June 30, 2013	December 31, 2012
Commercial real estate	\$ 329,599	\$ 335,561
Construction and land development	31,455	26,659
Commercial and industrial	108,951	103,768
Owner occupied real estate	137,219	126,242
Consumer and other	28,413	23,449
Residential mortgage	2,400	2,442
Total loans receivable	638,037	618,121
Deferred costs (fees)	(304)	(220)
Allowance for loan losses	(9,332)	(9,542)
Net loans receivable	\$ 628,401	\$ 608,359

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

The following table summarizes information with regard to impaired loans by loan portfolio class as of June 30, 2013 and December 31, 2012:

(dollars in thousands)	June 30, 2013			December 31, 2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial real estate	\$ 12,919	\$ 13,040	\$ -	\$ 19,231	\$ 20,000	\$ -
Construction and land development	1,029	4,244	-	3,153	6,312	-
Commercial and industrial	2,973	4,256	-	3,793	7,106	-
Owner occupied real estate	144	463	-	505	505	-
Consumer and other	668	917	-	912	1,146	-
Total	\$ 17,733	\$ 22,920	\$ -	\$ 27,594	\$ 35,069	\$ -
With an allowance recorded:						
Commercial real estate	\$ 8,227	\$ 8,889	\$ 958	\$ 6,085	\$ 6,085	\$ 1,077
Construction and land development	593	3,700	217	593	3,700	70
Commercial and industrial	3,263	5,663	992	3,147	3,255	861
Owner occupied real estate	3,002	3,002	498	3,450	3,450	860
Consumer and other	-	-	-	146	155	75
Total	\$ 15,085	\$ 21,254	\$ 2,665	\$ 13,421	\$ 16,645	\$ 2,943
Total:						
Commercial real estate	\$ 21,146	\$ 21,929	\$ 958	\$ 25,316	\$ 26,085	\$ 1,077
Construction and land development	1,622	7,944	217	3,746	10,012	70
Commercial and industrial	6,236	9,919	992	6,940	10,361	861
Owner occupied real estate	3,146	3,465	498	3,955	3,955	860
Consumer and other	668	917	-	1,058	1,301	75
Total	\$ 32,818	\$ 44,174	\$ 2,665	\$ 41,015	\$ 51,714	\$ 2,943

The following table presents additional information regarding the Company's impaired loans for the three months ended June 30, 2013 and June 30, 2012:

	Three Months Ended June 30,			
	2013		2012	
(dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial real estate	\$15,343	\$202	\$15,879	\$205
Construction and land development	1,822	8	5,227	29
Commercial and industrial	2,953	5	4,882	36
Owner occupied real estate	180	-	876	-
Consumer and other	725	-	784	2
Total	\$21,023	\$215	\$27,648	\$272
With an allowance recorded:				
Commercial real estate	\$7,056	\$25	\$5,707	\$52
Construction and land development	494	-	869	-
Commercial and industrial	3,504	14	3,350	12
Owner occupied real estate	3,149	37	2,472	36
Consumer and other	25	-	98	-
Total	\$14,228	\$76	\$12,496	\$100
Total:				
Commercial real estate	\$22,399	\$227	\$21,586	\$257
Construction and land development	2,316	8	6,096	29
Commercial and industrial	6,457	19	8,232	48
Owner occupied real estate	3,329	37	3,348	36
Consumer and other	750	-	882	2
Total	\$35,251	\$291	\$40,144	\$372

If these loans were performing under their original contractual rate, interest income on such loans would have increased approximately \$130,000 and \$153,000 for the three months ended June 30, 2013 and 2012, respectively.

The following table presents additional information regarding the Company's impaired loans for the six months ended June 30, 2013 and June 30, 2012:

	Six Months Ended June 30,			
	2013		2012	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
(dollars in thousands)				
With no related allowance recorded:				
Commercial real estate	\$ 17,766	\$ 421	\$ 14,315	\$ 370
Construction and land development	2,615	29	4,980	59
Commercial and industrial	2,935	11	4,286	78
Owner occupied real estate	216	-	1,183	27
Consumer and other	781	1	850	4
Total	\$ 24,313	\$ 462	\$ 25,614	\$ 538
With an allowance recorded:				
Commercial real estate	\$5,885	\$61	\$6,604	\$135
Construction and land development	395	-	1,496	-
Commercial and industrial	3,746	28	3,941	19
Owner occupied real estate	3,295	73	1,911	48
Consumer and other	49	-	49	-
Total	\$13,370	\$162	\$14,001	\$202
Total:				
Commercial real estate	\$ 23,651	\$ 482	\$ 20,919	\$ 505
Construction and land development	3,010	29	6,476	59
Commercial and industrial	6,681	39	8,227	97
Owner occupied real estate	3,511	73	3,094	75
Consumer and other	830	1	899	4
Total	\$ 37,683	\$ 624	\$ 39,615	\$ 740

If these loans were performing under their original contractual rate, interest income on such loans would have increased approximately \$339,000 and \$320,000 for the six months ended June 30, 2013 and 2012, respectively.

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The following tables provide the activity in and ending balances of the allowance for loan losses by loan portfolio class at and for the three and six months ended June 30, 2013 and 2012:

(dollars in thousands)	Commercial Real Estate	Construction and Land Development	Commercial and Industrial	Owner Occupied Real Estate	Consumer and Other	Residential Mortgage	Unallocated	Total
Three months ended June 30, 2013								
Allowance for loan losses:								
Beginning balance:	\$ 3,257	\$ 1,835	\$ 2,336	\$ 1,297	\$ 170	\$ 14	\$ 444	\$ 9,353
Charge-offs	(349)	-	(361)	(319)	-	-	-	(1,029)
Recoveries	54	-	4	-	25	-	-	83
Provisions (credits)	619	667	18	8	(4)	-	(383)	925
Ending balance	\$ 3,581	\$ 2,502	\$ 1,997	\$ 986	\$ 191	\$ 14	\$ 61	\$ 9,332

Three months ended June 30, 2012								
Allowance for loan losses:								
Beginning balance:	\$ 4,371	\$ 2,169	\$ 2,219	\$ 1,455	\$ 106	\$ 20	\$ 416	\$ 10,756
Charge-offs	(274)	(921)	(708)	-	(100)	-	-	(2,003)
Recoveries	-	105	-	-	27	-	-	132
Provisions (credits)	(136)	63	305	171	101	(4)	-	500
Ending balance	\$ 3,961	\$ 1,416	\$ 1,816	\$ 1,626	\$ 134	\$ 16	\$ 416	\$ 9,385

(dollars in thousands)	Commercial Real Estate	Construction and Land Development	Commercial and Industrial	Owner Occupied Real Estate	Consumer and Other	Residential Mortgage	Unallocated	Total
Six months ended June 30, 2013								
Allowance for loan losses:								
Beginning balance:	\$ 3,979	\$ 1,273	\$ 1,880	\$ 1,967	\$ 234	\$ 17	\$ 192	\$ 9,542
Charge-offs	(409)	(55)	(361)	(319)	(75)	-	-	(1,219)
Recoveries	54	-	5	-	25	-	-	84
Provisions (credits)	(43)	1,284	473	(662)	7	(3)	(131)	925
Ending balance	\$ 3,581	\$ 2,502	\$ 1,997	\$ 986	\$ 191	\$ 14	\$ 61	\$ 9,332

Six months ended June 30, 2012								
Allowance for loan losses:								
Beginning Balance:	\$ 7,372	\$ 558	\$ 1,928	\$ 1,963	\$ 113	\$ 23	\$ 93	\$ 12,050
Charge-offs	(766)	(921)	(760)	-	(101)	-	-	(2,548)
Recoveries	-	105	-	-	28	-	-	133

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Provisions (credits)	(2,645)	1,674	648	(337)	94	(7)	323	(250)
Ending balance	\$ 3,961	\$ 1,416	\$ 1,816	\$ 1,626	\$ 134	\$ 16	\$ 416	\$ 9,385

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The following tables provide a summary of the allowance for loan losses and balance of loans receivable by loan class and by impairment method as of June 30, 2013 and December 31, 2012:

(dollars in thousands)	Commercial Real Estate	Construction and Land Development	Commercial and Industrial	Owner Occupied Real Estate	Consumer and Other	Residential Mortgage	Unallocated	Total
June 30, 2013								
Allowance for loan losses:								
Individually evaluated for impairment	\$ 958	\$ 217	\$ 992	\$ 498	\$ -	\$ -	\$ -	\$ 2,665
Collectively evaluated for impairment	2,623	2,285	1,005	488	191	14	61	6,667
Total allowance for loan losses	\$ 3,581	\$ 2,502	\$ 1,997	\$ 986	\$ 191	\$ 14	\$ 61	\$ 9,332
Loans receivable:								
Loans evaluated individually	\$ 21,146	\$ 1,622	\$ 6,236	\$ 3,146	\$ 668	\$ -	\$ -	\$ 32,818
Loans evaluated collectively	308,453	29,833	102,715	134,073	27,745	2,400	-	605,219
Total loans receivable	\$ 329,599	\$ 31,455	\$ 108,951	\$ 137,219	\$ 28,413	\$ 2,400	\$ -	\$ 638,037

(dollars in thousands)	Commercial Real Estate	Construction and Land Development	Commercial and Industrial	Owner Occupied Real Estate	Consumer and Other	Residential Mortgage	Unallocated	Total
December 31, 2012								
Allowance for loan losses:								
Individually evaluated for impairment	\$ 1,077	\$ 70	\$ 861	\$ 860	\$ 75	\$ -	\$ -	\$ 2,943
Collectively evaluated for impairment	2,902	1,203	1,019	1,107	159	17	192	6,599
Total allowance for loan losses	\$ 3,979	\$ 1,273	\$ 1,880	\$ 1,967	\$ 234	\$ 17	\$ 192	\$ 9,542
Loans receivable:								
	\$ 25,316	\$ 3,746	\$ 6,940	\$ 3,955	\$ 1,058	\$ -	\$ -	\$ 41,015

Loans evaluated individually								
Loans evaluated collectively	310,245	22,913	96,828	122,287	22,391	2,442	-	577,106
Total loans receivable	\$ 335,561	\$ 26,659	\$ 103,768	\$ 126,242	\$ 23,449	\$ 2,442	\$ -	\$ 618,121

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past due status as of June 30, 2013 and December 31, 2012:

(dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Loans Receivable > 90	
						Total Loans Receivable	Days and Accruing
At June 30, 2013							
Commercial real estate	\$ 4,472	\$ 12,824	\$ 6,816	\$ 24,112	\$ 305,487	\$ 329,599	\$ -
Construction and land development	-	-	1,622	1,622	29,833	31,455	-
Commercial and industrial	-	-	4,028	4,028	104,923	108,951	-
Owner occupied real estate	969	-	207	1,176	136,043	137,219	-
Consumer and other	42	-	667	709	27,704	28,413	-
Residential mortgage	-	-	-	-	2,400	2,400	-
Total	\$ 5,483	\$ 12,824	\$ 13,340	\$ 31,647	\$ 606,390	\$ 638,037	\$ -

(dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Loans Receivable > 90	
						Total Loans Receivable	Days and Accruing
At December 31, 2012							
Commercial real estate	\$ 772	\$ 26,000	\$ 7,987	\$ 34,759	\$ 300,802	\$ 335,561	\$ -
Construction and land development	-	261	1,342	1,603	25,056	26,659	-
Commercial and industrial	86	-	4,693	4,779	98,989	103,768	-
Owner occupied real estate	285	1,562	968	2,815	123,427	126,242	-
Consumer and other	-	-	1,058	1,058	22,391	23,449	202
Residential mortgage	-	-	-	-	2,442	2,442	-
Total	\$ 1,143	\$ 27,823	\$ 16,048	\$ 45,014	\$ 573,107	\$ 618,121	\$ 202

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system as of June 30, 2013 and December 31, 2012:

(dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
At June 30, 2013:					
Commercial real estate	\$292,052	\$15,839	\$21,708	\$-	\$329,599
Construction and land development	29,833	-	1,622	-	31,455
Commercial and industrial	101,887	695	6,369	-	108,951
Owner occupied real estate	133,247	826	3,146	-	137,219
Consumer and other	27,413	75	925	-	28,413
Residential mortgage	2,400	-	-	-	2,400
Total	\$586,832	\$17,435	\$33,770	\$-	\$638,037

(dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
At December 31, 2012:					
Commercial real estate	\$300,174	\$9,174	\$26,213	\$-	\$335,561
Construction and land development	22,652	261	3,746	-	26,659
Commercial and industrial	96,051	642	7,075	-	103,768
Owner occupied real estate	121,381	906	3,955	-	126,242
Consumer and other	22,033	100	1,316	-	23,449
Residential mortgage	2,442	-	-	-	2,442
Total	\$564,733	\$11,083	\$42,305	\$-	\$618,121

The following table shows non-accrual loans by class as of June 30, 2013 and December 31, 2012:

(dollars in thousands)	June 30, 2013	December 31, 2012
Commercial real estate	\$ 6,816	\$ 7,987
Construction and land development	1,622	1,342
Commercial and industrial	4,028	4,693
Owner occupied real estate	207	968
Consumer and other	667	856
Residential mortgage	-	-
Total	\$ 13,340	\$ 15,846

Troubled Debt Restructurings

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

combination of any of these conditions.

The following table summarizes the balance of outstanding TDRs for the period ended June 30, 2013 and December 31, 2012:

(dollars in thousands)	Number of Loans	Accrual Status	Non- Accrual Status	Total TDRs
June 30, 2013				
Commercial real estate	1	\$595	\$-	\$595
Construction and land development	-	-	-	-
Commercial and industrial	1	2,208	-	2,208
Owner occupied real estate	1	1,914	-	1,914
Consumer and other	-	-	-	-
Residential mortgage	-	-	-	-
Total	3	\$4,717	\$-	\$4,717
December 31, 2012				
Commercial real estate	1	\$1,261	\$-	\$1,261
Construction and land development	1	2,069	-	2,069
Commercial and industrial	1	2,248	-	2,248
Owner occupied real estate	1	1,933	-	1,933
Consumer and other	-	-	-	-
Residential mortgage	-	-	-	-
Total	4	\$7,511	\$-	\$7,511

All TDRs are considered impaired and are therefore individually evaluated for impairment in the calculation of the allowance for loan losses. Some TDRs may not ultimately result in the full collection of principal and interest as restructured and could lead to potential incremental losses. These potential incremental losses would be factored into our estimate of the allowance for loan losses. The level of any subsequent defaults will likely be affected by future economic conditions. There were no loan modifications that were considered TDRs during the three and six months ended June 30, 2013 and 2012.

After a loan is determined to be a TDR, we continue to track its performance under the most recent restructured terms. There were no TDRs that subsequently defaulted during the six month period ended June 30, 2013 nor the twelve month period ended December 31, 2012.

Note 7: Fair Value of Financial Instruments

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

The Company follows the guidance issued under ASC 820-10, Fair Value Measurements and Disclosures, which defines fair value, establishes a framework for measuring fair value under GAAP, and identifies required disclosures on fair value measurements.

ASC 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820-10 are as follows:

- Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.
- Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

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

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2013 and December 31, 2012 were as follows:

(dollars in thousands)	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
June 30, 2013				
Collateralized mortgage obligations	\$104,768	\$-	\$104,768	\$ -
Mortgage-backed securities	18,305	-	18,305	-
Municipal securities	5,360	-	5,360	-
Corporate bonds	32,976	-	29,970	3,006
Asset-backed securities	19,684	-	19,684	-
Trust Preferred Securities	3,162	-	-	3,162
Other securities	116	-	116	-
Securities Available for Sale	\$184,371	\$-	\$178,203	\$ 6,168
December 31, 2012				
Collateralized mortgage obligations	\$99,783	\$-	\$99,783	\$-
Mortgage-backed securities	21,640	-	21,640	-
Municipal securities	12,101	-	12,101	-
Corporate bonds	32,685	-	29,678	3,007
Asset-backed securities	19,729	-	19,729	-
Trust Preferred Securities	3,187	-	-	3,187
Other securities	134	-	134	-
Securities Available for Sale	\$189,259	\$-	\$183,065	\$6,194

The following table presents a reconciliation of the securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2013 and 2012:

Level 3 Investments Only (dollars in thousands)	Three Months Ended June 30, 2013		Three Months Ended June 30, 2012	
	Trust		Trust	
	Preferred Securities	Corporate Bonds	Preferred Securities	Corporate Bonds
Balance, April 1st	\$ 3,238	\$ 3,007	\$ 3,399	\$ 3,007
Unrealized losses	(65)	(1)	(117)	-
Paydowns	(11)	-	(93)	-
Impairment charges on Level 3	-	-	(14)	-
Balance, June 30th	\$ 3,162	\$ 3,006	\$ 3,175	\$ 3,007

Level 3 Investments Only (dollars in thousands)	Six Months Ended June 30, 2013		Six Months Ended June 30, 2012	
	Trust		Trust	
	Preferred Securities	Corporate Bonds	Preferred Securities	Corporate Bonds
Balance, January 1st	\$ 3,187	\$ 3,007	\$ 3,410	\$ 3,004
Unrealized gains (losses)	(7)	(1)	(111)	3
Paydowns	(18)	-	(93)	-
Impairment charges on Level 3	-	-	(31)	-
Balance, June 30th	\$ 3,162	\$ 3,006	\$ 3,175	\$ 3,007

For assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2013 and December 31, 2012 were as follows:

(dollars in thousands)	Total	(Level 1)	(Level 2)	(Level 3)
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
June 30, 2013:				
Impaired loans	\$14,615	\$-	\$-	\$ 14,615
Other real estate owned	3,348	-	-	3,348
SBA servicing assets	2,904	-	-	2,904
December 31, 2012:				
Impaired loans	\$19,876	\$-	\$-	\$ 19,876
Other real estate owned	3,642	-	-	3,642
SBA servicing assets	2,340	-	-	2,340

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

Quantitative Information about Level 3 Fair Value Measurements
June 30, 2013

Asset Description	Fair Value	Valuation Technique	Unobservable Input	Range Weighted Average
Impaired loans	\$ 14,615	Fair Value of Collateral (1)	Appraised Value (2)	0% - 43% (17%) (4)
Other real estate owned	\$ 3,348	Fair Value of Collateral (1)	Appraised Value (2) Sales Price	8% - 14% (9%) (4)
SBA Servicing Assets	\$ 2,904	Fair Value	Individual Loan Valuation (3)	(3)

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

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

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

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

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

The following table presents an analysis of the activity in the SBA servicing assets for the three and six months ended June 30, 2013 and 2012:

(dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Beginning balance	\$ 2,491	\$ 1,351	\$ 2,340	\$ 1,102
Additions	482	237	628	478
Fair value adjustments	(69)	42	(64)	50
Ending balance	\$ 2,904	\$ 1,630	\$ 2,904	\$ 1,630

Fair Value Assumptions

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at June 30, 2013 and December 31, 2012.

Cash and Cash Equivalents (Carried at Cost)

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

Investment Securities

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

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

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

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

An independent, third party pricing service is used to estimate the current fair market value of each CDO held in the investment securities portfolio. The calculations used to determine fair value are based on the attributes of the trust preferred securities, the financial condition of the issuers of the trust preferred securities, and market based assumptions. The INTEX CDO Deal Model Library was utilized to obtain information regarding the attributes of each security and its specific collateral as of June 30, 2013 and December 31, 2012. Financial information on the issuers was also obtained from Bloomberg, the FDIC, the Office of Thrift Supervision and SNL Financial. Both published and unpublished industry sources were utilized in estimating fair value. Such information includes loan prepayment speed assumptions, discount rates, default rates, and loss severity percentages. Due to the current state of the global capital and financial markets, the fair market valuation is subject to greater uncertainty than would otherwise exist.

The fair market valuation for each CDO was determined based on discounted cash flow analyses. The cash flows are primarily dependent on the estimated speeds at which the trust preferred securities are expected to prepay, the

estimated rates at which the trust preferred securities are expected to defer payments, the estimated rates at which the trust preferred securities are expected to default, and the severity of the losses on securities that do default.

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

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

Loans Receivable, including Loans Held For Sale (Carried at Cost)

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

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

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

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

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

SBA Servicing Asset (Carried at Fair Value)

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

The Company uses assumptions and estimates in determining the impairment of the SBA servicing asset. These assumptions include prepayment speeds and discount rates commensurate with the risks involved and comparable to assumptions used by participants to value and bid serving rights available for sale in the market. At June 30, 2013 and December 31, 2012, the sensitivity of the current fair value of the SBA loan servicing rights to immediate 10% and 20% adverse changes in key assumptions are included in the accompanying table.

(dollars in thousands)	June 30, 2013	December 31, 2012
SBA Servicing Asset		
Fair Value of SBA Servicing Asset	\$ 2,904	\$ 2,340
Composition of SBA Loans Serviced for Others		
Fixed-rate SBA loans	0 %	0 %
Adjustable-rate SBA loans	100 %	100 %
Total	100 %	100 %
Weighted Average Remaining Term	21.1 years	21.4 years
Prepayment Speed	6.49 %	6.59 %
Effect on fair value of a 10% increase	\$ (68)	\$ (55)
Effect on fair value of a 20% increase	(132)	(107)
Weighted Average Discount Rate	13.42 %	14.23 %
Effect on fair value of a 10% increase	\$ (132)	\$ (115)
Effect on fair value of a 20% increase	(255)	(222)

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

Restricted Stock (Carried at Cost)

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

Accrued Interest Receivable and Payable (Carried at Cost)

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

Deposit Liabilities (Carried at Cost)

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

applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Subordinated Debt (Carried at Cost)

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

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

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

The estimated fair values of the Company's financial instruments were as follows at June 30, 2013 and December 31, 2012:

(dollars in thousands)	Fair Value Measurements at June 30, 2013				
	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Balance Sheet Data					
Financial assets:					
Cash and cash equivalents	\$ 56,784	\$ 56,784	\$ 56,784	\$ -	\$ -
Investment securities available for sale	184,371	184,371	-	178,203	6,168
Investment securities held to maturity	68	69	-	69	-
Restricted stock	2,326	2,326	-	2,326	-
Loans held for sale	282	282	-	-	282
Loans receivable, net	628,401	620,770	-	-	620,770
SBA servicing assets	2,904	2,904	-	-	2,904
Accrued interest receivable	2,969	2,969	-	2,969	-
Financial liabilities:					
Deposits					
Demand, savings and money market	\$ 732,642	\$ 732,642	\$ -	\$ 732,642	\$ -
Time	88,210	88,699	-	88,699	-
Subordinated debt	22,476	17,663	-	-	17,663
Accrued interest payable	522	522	-	522	-
Off-Balance Sheet Data					
Commitments to extend credit	-	-	-	-	-
Standby letters-of-credit	-	-	-	-	-

(dollars in thousands)	Fair Value Measurements at December 31, 2012				
	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Balance Sheet Data					
Financial assets:					
Cash and cash equivalents	\$ 128,004	\$ 128,004	\$ 128,004	\$ -	\$ -
Investment securities available for sale	189,259	189,259	-	183,065	6,194

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Investment securities held to maturity	67	69	-	69	-
Restricted stock	3,816	3,816	-	3,816	-
Loans held for sale	82	82	-	-	82
Loans receivable, net	608,359	603,237	-	-	603,237
SBA servicing assets	2,340	2,340	-	-	2,340
Accrued interest receivable	3,128	3,128	-	3,128	-
Financial liabilities:					
Deposits					
Demand, savings and money market					
	\$ 765,967	\$ 765,967	\$ -	\$ 765,967	\$ -
Time	123,234	124,044	-	124,044	-
Subordinated debt	22,476	20,187	-	-	20,187
Accrued interest payable	301	301	-	301	-
Off-Balance Sheet Data					
Commitments to extend credit	-	-	-	-	-
Standby letters-of-credit	-	-	-	-	-

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

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

Certain statements in this report may be considered to be "forward-looking statements" as that term is defined in the U.S. Private Securities Litigation Reform Act of 1995, such as statements that include the words "would be," "could be," "should be," "probability," "risk," "target," "objective," "may," "will," "estimate," "project," "believe," "intend," "anticipate," and similar expressions or variations on such expressions. The forward-looking statements contained herein are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. For example, risks and uncertainties can arise with changes in: general economic conditions, including turmoil in the financial markets and related efforts of government agencies to stabilize the financial system; business conditions in the financial services industry, including competitive pressure among financial services companies, new service and product offerings by competitors, price pressures and similar items. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. The Company undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date hereof, except as may be required by applicable laws or regulations. Readers should carefully review the risk factors described in the Form 10-K for the year ended December 31, 2012 and other documents the Company files from time to time with the SEC, such as Quarterly Reports on Form 10-Q, and any Current Reports on Form 8-K, as well as other filings.

Regulatory Reform and Legislation

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") has and will continue to have a broad impact on the financial services industry, including significant regulatory and compliance changes including, among other things, (i) enhanced resolution authority of troubled and failing banks and their holding companies; (ii) increased capital and liquidity requirements; (iii) increased regulatory examination fees; (iv) changes to assessments to be paid to the FDIC for federal deposit insurance; and (v) numerous other provisions designed to improve supervision and oversight of, and strengthening safety and soundness for, the financial services sector. Additionally, the Dodd-Frank Act establishes a new framework for systemic risk oversight within the financial system to be distributed among new and existing federal regulatory agencies, including the Financial Stability Oversight Council, the Consumer Financial Protection Bureau, the Federal Reserve, the Office of the Comptroller of the Currency, and the FDIC. A summary of certain provisions of the Dodd-Frank Act is set forth in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

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

In June 2012, the federal bank regulatory agencies issued a series of proposed revisions to the agencies' capital adequacy guidelines and prompt corrective action rules, which were designed to enhance such requirements and implement the revised standards of the Basel Committee on Banking Supervision, commonly referred to as Basel III. In July 2013, the federal bank regulatory agencies adopted final rules, which differ in certain respects from the June 2012 proposals.

The July 2013 final rules generally implement higher minimum capital requirements, add a new common equity tier 1 capital requirement, and establish criteria that instruments must meet to be considered common equity tier 1 capital, additional tier 1 capital or tier 2 capital. The new minimum capital to risk-adjusted assets requirements are a common equity tier 1 capital ratio of 4.5% (6.5% to be considered "well capitalized") and a tier 1 capital ratio of 6.0%, increased from 4.0% (and increased from 6.0% to 8.0% to be considered "well capitalized"); the total capital ratio remains at 8.0% under the new rules (10.0% to be considered "well capitalized"). Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity tier 1 capital above its minimum risk-based capital requirements in an amount greater than 2.5% of total risk-weighted assets. The new minimum capital requirements are effective on January 1, 2015. The capital contribution buffer requirements phase in over a three-year period beginning January 1, 2016.

The July 2013 final rules include three significant changes from the June 2012 proposals: (i) the final rules do not change the current risk weighting for residential mortgage exposures; (ii) the final rules permit institutions, other than certain large institutions, to elect to continue to treat certain components of accumulated other comprehensive income as permitted under the current general risk-based capital rules, and not reflect unrealized gains and losses on available-for-sale securities in common equity tier 1 calculations; and (iii) the final rules permit institutions with less than \$15.0 billion in assets to grandfather certain non-qualifying capital instruments (including trust preferred securities) issued prior to May 19, 2009 into tier 1 capital.

The Company and the Bank will continue to analyze these new rules and their effects on the business, operations and capital levels of the Company and the Bank.

Financial Condition

Assets

Total assets decreased by \$69.0 million, or 7.0%, to \$919.7 million at June 30, 2013, compared to \$988.7 million at December 31, 2012, mainly due to decreases in cash and cash equivalents and deposit balances.

Cash and Cash Equivalents

Cash and due from banks and interest bearing deposits comprise this category, which consists of our most liquid assets. The aggregate amount in these two categories decreased by \$71.2 million, to \$56.8 million at June 30, 2013, from \$128.0 million at December 31, 2012. This decrease was primarily caused by a \$68.3 million decrease in deposit balances during the first six months of 2013.

Loans Held for Sale

Loans held for sale are comprised of loans guaranteed by the U.S. Small Business Administration ("SBA") which the Company usually originates with the intention of selling in the future. Total SBA loans held for sale were \$282,000 at June 30, 2013 as compared to \$82,000 at December 31, 2012. Loans held for sale, as a percentage of total Company

assets, were less than 1% at June 30, 2013.

Loans Receivable

The loan portfolio represents our largest asset category and is our most significant source of interest income. Our lending strategy is focused on small and medium size businesses and professionals that seek highly personalized banking services. The loan portfolio consists of secured and unsecured commercial loans including commercial real estate, construction loans, residential mortgages, automobile loans, home improvement loans, home equity loans and lines of credit, overdraft lines of credit and others. Commercial loans typically range between \$250,000 and \$5,000,000 but customers may borrow significantly larger amounts up to our legal lending limit to a customer, which was approximately \$14.8 million at June 30, 2013. Loans made to one individual customer, even if secured by different collateral, are aggregated for purposes of the lending limit.

Loans increased \$19.8 million, or 3.2%, to \$637.7 million at June 30, 2013, compared to \$617.9 million at December 31, 2012, driven by an increase in loan demand resulting in higher originations during the first six months of 2013.

Investment Securities

Investment securities considered available-for-sale are investments which may be sold in response to changing market and interest rate conditions, and for liquidity and other purposes. Our investment securities classified as available-for-sale consist primarily of U.S. Government agency mortgage-backed securities (MBS), agency collateralized mortgage obligations (CMO), corporate bonds, municipal securities, asset-backed securities (ABS), and pooled trust preferred securities (CDO). Available-for-sale securities totaled \$184.4 million at June 30, 2013, compared to \$189.3 million at December 31, 2012. The decrease was primarily due to proceeds from the sales and maturities of securities totaling \$26.3 million partially offset by purchase of investment securities considered available for sale totaling \$25.3 million during the first six months of 2013. At June 30, 2013, the portfolio had a net unrealized loss of \$2.6 million compared to a net unrealized gain of \$1.6 million at December 31, 2012. The change in value of the investment portfolio, from an unrealized gain to an unrealized loss, was driven by an increase in market interest rates and widening asset spreads during the second quarter of 2013.

Investment securities held-to-maturity are investments for which there is the intent and ability to hold the investment to maturity. These investments are carried at amortized cost. The held-to-maturity portfolio consists primarily of debt securities. At June 30, 2013 and December 31, 2012, securities held to maturity totaled \$68,000 and \$67,000, respectively. At both dates, respective carrying values approximated market values.

Restricted Stock

Restricted stock, which represents required investment in the capital stock of correspondent banks related to available credit facilities, is carried at cost as of June 30, 2013 and December 31, 2012. As of those dates, restricted stock consisted of investments in the capital stock of the Federal Home Loan Bank of Pittsburgh (“FHLB”) and Atlantic Central Bankers Bank (“ACBB”). During the first and second quarter of 2013, FHLB repurchased 41% of Republic’s total restricted stock outstanding, continuing its recent policy of quarterly repurchases of capital stock in excess of the minimum required investment. In 2012, the FHLB repurchased 29% of Republic’s total restricted stock outstanding. Decisions regarding any future repurchases of restricted stock by the FHLB of Pittsburgh will be made on a quarterly basis. The FHLB also issued a dividend payment during the first and second quarter of 2013.

At June 30, 2013 and December 31, 2012, the investment in FHLB of Pittsburgh capital stock totaled \$2.2 million and \$3.7 million, respectively. At both June 30, 2013 and December 31, 2012, ACBB capital stock totaled \$143,000.

Bank Owned Life Insurance

At June 30, 2013, the value of the insurance was \$0, compared to \$10.5 million at December 31, 2012. The decrease was due to surrender proceeds of \$10.5 million received in the second quarter of 2013.

Deposits

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

Total deposits decreased by \$68.3 million, or 7.7%, to \$820.9 million at June 30, 2013 from \$889.2 million at December 31, 2012. The decrease was primarily the result of reductions in certificates of deposit of \$35.0 million and money market accounts of \$31.8 million. The decrease in money market accounts was primarily driven by the timing of cash flow requirements for certain large deposit relationships during the first six months of 2013. The decrease in certificates of deposit was the result of maturities of internet-based certificates of deposit which the Company considers non-core deposits and intentionally decided not to renew.

Shareholders' Equity

Total shareholders' equity decreased \$534,000 to \$69.4 million at June 30, 2013, compared to \$69.9 million at December 31, 2012, primarily due to accumulated other comprehensive losses associated with unrealized losses in the investment securities portfolio partially offset by net income recognized during the first six months of 2013. The shift in market value of the securities portfolio resulting in accumulated other comprehensive losses of \$1.7 million at June 30, 2013 compared to accumulated other comprehensive income of \$1.0 million at December 31, 2012 was primarily driven by an increase in market interest rates and widening asset spreads during the period.

Results of Operations

Three Months Ended June 30, 2013 Compared to Three Months Ended June 30, 2012

The Company reported net income of \$1.0 million, or \$0.04 per share, for the three months ended June 30, 2013, compared to net income of \$1.0 million, or \$0.04 per share, for the three months ended June 30, 2012.

Net interest income for the three month period ended June 30, 2013 was \$8.1 million compared to \$8.0 million for the three months ended June 30, 2012. Interest income decreased \$434,000 for the three months ended June 30, 2013 compared to June 30, 2012. Interest expense decreased \$507,000, or 31.2%, to \$1.1 million for the three months ended June 30, 2013 compared to \$1.6 million for the three months ended June 30, 2012. This decrease was primarily due to a 21 basis point decrease in the rate on average deposits outstanding to 0.41%.

Non-interest income increased by \$371,000 to \$2.9 million during the three months ended June 30, 2013 compared to \$2.5 million during the three months ended June 30, 2012. The Company recognized \$2.1 million in gains on the sale of SBA loans for the three months ended June 30, 2013 compared to \$1.1 million for the three months ended June 30, 2012 as a result of higher SBA loan originations during the current period. These were partially offset by gains on the sale of investment securities totaling \$774,000 recognized during the prior year quarter.

Non-interest expenses increased \$46,000 to \$9.1 million during the three months ended June 30, 2013 compared to \$9.0 million during the three months ended June 30, 2012. An increase in salaries and benefits of \$540,000 driven

primarily by annual merit increases was offset by a decrease of \$395,000 in legal fees as a result of lower costs related to the resolution of troubled loans.

Return on average assets and average equity was 0.44% and 5.77%, respectively, during the three months ended June 30, 2013 compared to 0.42% and 6.06%, respectively, for the three months ended June 30, 2012.

Six Months Ended June 30, 2013 compared to June 30, 2012

The Company reported net income of \$2.0 million, or \$0.08 per share, for the six months ended June 30, 2013 compared to net income of \$2.3 million, or \$0.09 per share, for the six months ended June 30, 2012. The decrease in net income was primarily driven by an increase in the required provision for loan losses. The Company recorded a provision in the amount of \$925,000 for the six months ended June 30, 2013 compared to a negative (credit) provision of \$250,000 during the six months ended June 30, 2012. The negative provision recorded for the six months ended June 30, 2012 was driven by a reduction in the allowance for loan losses related to non-impaired loans evaluated collectively for impairment due to a change in the analysis of historical losses.

Net interest income for the six months ended June 30, 2013 increased \$250,000 to \$16.0 million as compared to \$15.7 million for the six months ended June 30, 2012. Interest income decreased \$903,000, or 4.7%, due to decreases in yields on loans and investment securities and interest expense decreased \$1.2 million, or 32.7%, primarily due to a 23 basis point decrease in the rate on average deposits outstanding.

Non-interest income increased \$968,000 to \$5.1 million during the six months ended June 30, 2013 as compared to \$4.1 million during the six months ended June 30, 2012 primarily due to an increase in gains recognized on the sale of SBA loans and increases in loan advisory and servicing fees during the six months ended June 30, 2013.

Non-interest expenses increased \$340,000 to \$18.2 million during the six months ended June 30, 2013 as compared to \$17.8 million during the six months ended June 30, 2012. Return on average assets and average equity from continuing operations were 0.43% and 5.77%, respectively, during the six months ended June 30, 2013 compared to 0.48% and 7.04%, respectively, for the six months ended June 30, 2012.

Analysis of Net Interest Income

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

Average Balances and Net Interest Income

(dollars in thousands)	For the three months ended June 30, 2013			For the three months ended June 30, 2012		
	Average Balance	Interest	Yield/ Rate(1)	Average Balance	Interest	Yield/ Rate(1)
Interest-earning assets:						
Federal funds sold and other interest-earning assets	\$ 62,419	\$ 44	0.28 %	\$ 119,275	\$ 84	0.28 %
Investment securities and restricted stock	182,025	1,117	2.45 %	185,091	1,449	3.13 %
Loans receivable	633,547	8,128	5.15 %	606,617	8,215	5.45 %
Total interest-earning assets	877,991	9,289	4.24 %	910,983	9,748	4.30 %
Other assets	50,912			56,084		
Total assets	\$ 928,903			\$ 967,067		
Interest-earning liabilities:						
Demand – non-interest bearing	\$ 141,390			\$ 125,528		
Demand – interest bearing	180,824	207	0.46 %	126,025	185	0.59 %
Money market & savings	417,567	428	0.41 %	461,622	722	0.63 %
Time deposits	88,994	204	0.92 %	157,013	433	1.11 %
Total deposits	828,775	839	0.41 %	870,188	1,340	0.62 %
Total interest-bearing deposits	687,385	839	0.49 %	744,660	1,340	0.72 %
Other borrowings	22,476	278	4.96 %	22,526	284	5.07 %
Total interest-bearing liabilities	709,861	1,117	0.63 %	767,186	1,624	0.85 %
Total deposits and other borrowings	851,251	1,117	0.53 %	892,714	1,624	0.73 %
Non interest-bearing other liabilities	7,379			7,506		
Shareholders' equity	70,273			66,847		
Total liabilities and shareholders' equity	\$ 928,903			\$ 967,067		
Net interest income (2)		\$ 8,172			\$ 8,124	
Net interest spread			3.61 %			3.45 %
Net interest margin (2)			3.73 %			3.59 %

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

(2) Net interest income and net interest margin are presented on a tax equivalent basis. Net interest income has been increased over the financial statement amount by \$74 and \$99 for the three months ended June 30, 2013 and 2012,

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

Average Balances and Net Interest Income

(dollars in thousands)	For the six months ended June 30, 2013			For the six months ended June 30, 2012		
	Average Balance	Interest	Yield/ Rate(1)	Average Balance	Interest	Yield/ Rate(1)
Interest-earning assets:						
Federal funds sold and other interest-earning assets	\$ 74,485	103	0.28 %	\$ 140,689	\$ 185	0.25 %
Investment securities and restricted stock	182,702	2,276	2.49 %	181,871	2,896	3.18 %
Loans receivable	627,628	16,105	5.17 %	599,722	16,342	5.48 %
Total interest-earning assets	884,815	18,484	4.21 %	922,282	19,423	4.24 %
Other assets	55,299			55,626		
Total assets	\$ 940,114			\$ 977,908		
Interest-earning liabilities:						
Demand – non-interest bearing	\$ 142,710			\$ 135,191		
Demand – interest bearing	175,873	402	0.46 %	121,910	356	0.59 %
Money market & savings	420,152	930	0.45 %	445,364	1,585	0.72 %
Time deposits	101,455	483	0.96 %	178,268	1,014	1.14 %
Total deposits	840,190	1,815	0.44 %	880,733	2,955	0.67 %
Total interest-bearing deposits	697,480	1,815	0.52 %	745,542	2,955	0.80 %
Other borrowings	22,476	556	4.99 %	22,550	569	5.07 %
Total interest-bearing liabilities	719,956	2,371	0.66 %	768,092	3,524	0.92 %
Total deposits and other borrowings	862,666	2,371	0.55 %	903,283	3,524	0.78 %
Non interest-bearing other liabilities	7,424			8,554		
Shareholders' equity	70,024			66,071		
Total liabilities and shareholders' equity	\$940,114			\$977,908		
Net interest income (2)		\$ 16,113			\$ 15,899	
Net interest spread			3.55%			3.32%
Net interest margin (2)			3.67%			3.47%

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

(2)Net interest income and net interest margin are presented on a tax equivalent basis. Net interest income has been increased over the financial statement amount by \$162 and \$198 for the six months ended June 30, 2013 and 2012, respectively, to adjust for tax equivalency. The tax equivalent net interest margin is calculated by dividing tax

equivalent net interest income by average total interest earning assets.

Rate/Volume Analysis of Changes in Net Interest Income

Net interest income may also be analyzed by segregating the volume and rate components of interest income and interest expense. The following table sets forth an analysis of volume and rate changes in net interest income for the three and six months ended June 30, 2013, as compared to the three and six months ended June 30, 2012. For purposes of this table, changes in interest income and expense are allocated to volume and rate categories based upon the respective changes in average balances and average rates.

(dollars in thousands)	For the three months ended June 30, 2013 vs. 2012			For the six months ended June 30, 2013 vs. 2012		
	Changes due to:			Changes due to:		
	Average Volume	Average Rate	Total Change	Average Volume	Average Rate	Total Change
Interest earned:						
Federal funds sold and other interest-earning assets	\$ (41)	\$ 1	\$ (40)	\$ (92)	\$ 10	\$ (82)
Securities	(20)	(312)	(332)	10	(630)	(620)
Loans	329	(416)	(87)	664	(901)	(237)
Total interest-earning assets	268	(727)	(459)	582	(1,521)	(939)
Interest expense:						
Deposits						
Interest-bearing demand deposits	63	(41)	22	123	(77)	46
Money market and savings	(44)	(250)	(294)	(50)	(605)	(655)
Time deposits	(157)	(72)	(229)	(366)	(165)	(531)
Total deposit interest expense	(138)	(363)	(501)	(293)	(847)	(1,140)
Other borrowings	-	(6)	(6)	-	(13)	(13)
Total interest expense	(138)	(369)	(507)	(293)	(860)	(1,153)
Net interest income	\$ 406	\$ (358)	\$ 48	\$ 875	\$ (661)	\$ 214

Net Interest Income

The Company's total tax equivalent interest income decreased \$459,000, or 4.7%, to \$9.3 million for the three months ended June 30, 2013 compared to \$9.7 million for the three months ended June 30, 2012. A \$26.9 million increase in average loans receivable was offset by a 30 basis point decrease in loan yields and a 68 basis point decrease in investment securities yields for the three months ended June 30, 2013 as compared to June 30, 2012. For the six months ended June 30, 2013, total tax equivalent interest income decreased \$939,000, or 4.8%, to \$18.5 million compared to the six months ended June 30, 2012. The increase in average loans receivable of \$27.9 million was offset by a 31 basis point decrease in loan yields and a 69 basis point decrease in investment securities yields for the six months ended June 30, 2013 as compared to June 30, 2012.

The Company's total interest expense decreased \$507,000, or 31.2%, to \$1.1 million for the three months ended June 30, 2013 compared to \$1.6 million for the three months ended June 30, 2012, as the Company continues to lower the rates paid on interest bearing deposit accounts. Total interest expense for the six months ended June 30, 2013 decreased \$1.2 million, or 32.7%, to \$2.4 million as compared to \$3.5 million for the six months ended June 30, 2012. Average deposit balances decreased \$41.4 million and \$40.5 million for the three and six months ended June 30, 2013 respectively, as a result of the Company's retail focused, customer service strategy, which emphasizes the gathering of low-cost core deposits and has enabled the Company to reduce its dependence on wholesale funding sources like higher cost internet-based certificates of deposit. The average rate paid on interest-bearing deposits decreased 23 basis points to 0.49%, and 28 basis points to 0.52%, for the three and six months ended June 30, 2013, respectively, compared to 0.72% and 0.80% for the same prior year periods. Average time deposit balances declined \$68.0 million and \$76.8 million for the three and six months ended June 30, 2013, respectively, primarily as a result of the intentional effort to reduce balances of non-core, internet-based CDs. The maturity and rollover of higher cost core customer time deposits resulted in the decrease in the average rate paid on time deposits of 19 basis points to 0.92%, and 18 basis points to 0.96% for the three and six months ended June 30, 2013 as compared to the same prior year periods. Accordingly, rates on total interest-bearing liabilities decreased 22 and 26 basis points during the three and six months ended June 30, 2013, respectively.

The tax equivalent net interest margin increased 14 basis points to 3.73% for the three months ended June 30, 2013, compared to 3.59% for the three months ended June 30, 2012 and the Company's tax equivalent net interest income increased \$48,000, or 0.6%, to \$8.2 million for the three months ended June 30, 2013 as compared to \$8.1 million for the three months ended June 30, 2012. For the six months ended June 30, 2013, the tax equivalent net interest margin increased 20 basis points to 3.67%, compared to 3.47% for the six months ended June 30, 2012 and the Company's tax equivalent net interest income increased \$214,000, or 1.3%, to \$16.1 million for the six months ended June 30, 2013 as compared to \$15.9 million for the six months ended June 30, 2012.

Provision for Loan Losses

The Company recorded a \$925,000 provision for loan losses for the three months ended June 30, 2013 compared to a \$500,000 provision for the three months ended June 30, 2012. The provision for loan losses is charged to operations in an amount necessary to bring the total allowance for loan losses to a level that management believes is adequate to absorb inherent losses in the loan portfolio. A provision of \$925,000 was recorded for the six months ended June 30, 2013 as compared to a negative (credit) provision for loan losses in the amount of \$250,000 for the six months ended June 30, 2012. The negative provision recorded during the first six months of 2012 was mainly attributable to improvement in credit quality in the loan portfolio, along with a reduction in the general reserve component of the allowance for loan losses caused by an adjustment to the analysis of historical losses during the period. See disclosure under "Credit Quality" and "Allowance for Loan Losses" for further discussion.

Non-Interest Income

Total non-interest income increased \$371,000 to \$2.9 million for the three months ended June 30, 2013, compared to \$2.5 million for the three months ended June 30, 2012. For the six months ended June 30, 2013, total non-interest income increased \$968,000 to \$5.1 million as compared to \$4.1 million for the six months ended June 30, 2012. The increases were primarily due to gains recognized on the sale of SBA loans for both the three and six months ended June 30, 2012.

Non-Interest Expenses

Total non-interest expenses increased \$46,000 to \$9.1 million for the three months ended June 30, 2013 as compared to \$9.0 million for the three months ended June 30, 2012. For the six months ended June 30, 2013, total non-interest expenses increased \$340,000 to \$18.2 million, compared to \$17.8 million for the six months ended June 30, 2012. For the six months ended June 30, 2013, other real estate owned expenses have increased \$824,000 due primarily to a writedown on a single property recorded in the current year and salaries and employee benefits which have increased by \$693,000 primarily driven by annual merit increases and higher incentive payouts made to the SBA lending team. These unfavorable variances were partially offset by a decrease in legal expenses of \$920,000 due to reduced costs associated with loan workouts and other corporate matters.

Benefit for Income Taxes

The Company recorded a benefit for income taxes of \$24,000 for the three months ended June 30, 2013, compared to a \$7,000 provision for the three months ended June 30, 2012. For the six months ended June 30, 2013, the Company recorded a benefit of \$50,000 compared to a benefit of \$62,000 for the six months ended June 30, 2012. The \$50,000 benefit recorded during the first six months of 2013 was the net result of a tax provision in the amount of \$560,000 calculated on the net profit generated during the period using the Company's normal estimated tax rate, offset by an adjustment to the deferred tax asset valuation allowance in the amount of \$610,000. The effective tax rates for the three-month periods ended June 30, 2013 and 2012 were 29% and 29%, respectively, and for the six month period ended June 30, 2013 and 2012 were 29% and 29%, respectively, excluding an adjustment to the deferred tax asset valuation allowance.

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

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

In assessing the need for a valuation allowance, the Company carefully weighed both positive and negative evidence currently available. Judgment is required when considering the relative impact of such evidence. The weight given to the potential effect of positive and negative evidence must be commensurate with the extent to which it can be objectively verified. A cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome. Based on the analysis of available positive and negative evidence, the Company determined that a valuation allowance should be recorded as of June 30, 2013 and December 31, 2012.

When calculating an estimate for a valuation allowance, the Company assessed the possible sources of taxable income available under tax law to realize a tax benefit for deductible temporary differences and carryforwards as defined in ASC 740-10-30. As a result of cumulative losses in recent years and the uncertain nature of the current economic environment, the Company did not use projections of future taxable income, exclusive of reversing temporary timing differences and carryforwards, as a factor. The Company will exclude future taxable income as a factor until it can show consistent and sustainable profitability.

The Company did assess tax planning strategies as defined under ASC 740-10-30 to determine the amount of a valuation allowance. Strategies reviewed included the sale of investment securities and loans with fair values greater than book values, redeployment of cash and cash equivalents into higher yielding investment options, a switch from tax-exempt to taxable investments and loans, and the election of a decelerated depreciation method for tax purposes on future fixed asset purchases. The Company believes that these tax planning strategies are (a) prudent and feasible,

(b) steps that the Company would not ordinarily take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in the realization of existing deferred tax assets. These tax planning strategies, if implemented, would result in taxable income in the first full reporting period after deployment and accelerate the recovery of deferred tax asset balances if faced with the inability to recover those assets or the risk of potential expiration. The Company believes that these are viable tax planning strategies and appropriately considered in the analysis at this time, but may not align with the strategic direction of the organization today and therefore, has no present intention to implement such strategies.

The net deferred tax asset balance before consideration of a valuation allowance was \$16.3 million as of June 30, 2013 and \$17.5 million as of December 31, 2012. The tax planning strategies assessed resulted in the projected realization of approximately \$3.0 million in tax assets which can be considered more likely than not to be realized as of June 30, 2013 and \$3.6 million as of December 31, 2012. Accordingly, the Company recorded a partial valuation allowance related to the deferred tax asset balance in the amount of \$13.3 million as of June 30, 2013 and \$13.9 million as of December 31, 2012.

The deferred tax asset will continue to be analyzed on a quarterly basis for changes affecting realizability. As the Company continues to record consecutive quarters of profitable results, projections of future taxable income become more reliable and can again be used as a factor in assessing the ability to fully realize the deferred tax asset.

Including the quarter ended June 30, 2013, the Company has reported six consecutive quarters of profitable results. Additional positive evidence assessed by management includes the Company's significantly improved risk profile, continued improvement in asset quality, sufficient liquidity, and strong capital ratios.

When the determination is made to include projections of future taxable income as a factor in recovering the deferred tax asset, the valuation allowance will be reduced accordingly resulting in a corresponding increase in net income. If the Company continues to experience sustained profitability and can project with reasonable certainty a continuation of profitability into 2014 and beyond it is reasonably possible that this adjustment could be made prior to the year ending December 31, 2013.

Commitments, Contingencies and Concentrations

Financial instruments, whose contract amounts represent potential credit risk, were commitments to extend credit of approximately \$96.5 million and \$99.7 million, and standby letters of credit of approximately \$3.0 million and \$4.3 million, at June 30, 2013 and December 31, 2012, respectively. These financial instruments constitute off-balance sheet arrangements. Commitments often expire without being drawn upon. Substantially all of the \$96.5 million of commitments to extend credit at June 30, 2013 were committed as variable rate credit facilities.

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

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

Regulatory Matters

The following table presents the capital regulatory ratios for both Republic and the Company as of June 30, 2013, and December 31, 2012 (dollars in thousands):

	Actual		For Capital Adequacy Purposes				To be well capitalized under regulatory capital guidelines	
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
At June 30, 2013:								
Total risk based capital								
Republic	\$ 98,357	12.90 %	\$ 60,983	8.00 %	\$ 76,228	10.00 %		
Company	98,899	12.95 %	61,091	8.00 %	-	-		
Tier one risk based capital								
Republic	89,025	11.68 %	30,491	4.00 %	45,737	6.00 %		
Company	89,567	11.73 %	30,546	4.00 %	-	-		
Tier one leveraged capital								
Republic	89,025	9.63 %	36,974	4.00 %	46,218	5.00 %		
Company	89,567	9.68 %	37,025	4.00 %	-	-		
At December 31, 2012:								
Total risk based capital								
Republic	\$ 96,366	12.70 %	\$ 60,685	8.00 %	\$ 75,857	10.00 %		
Company	97,006	12.73 %	60,971	8.00 %	-	-		
Tier one leveraged capital								
Republic	86,883	11.45 %	30,343	4.00 %	45,514	6.00 %		
Company	87,479	11.48 %	30,485	4.00 %	-	-		
Tier one leveraged capital								
Republic	86,883	8.96 %	38,786	4.00 %	48,483	5.00 %		
Company	87,479	9.01 %	38,838	4.00 %	-	-		

Dividend Policy

The Company has not paid any cash dividends on its common stock. The Company has no plans to pay cash dividends in 2013. The Company's ability to pay dividends depends primarily on receipt of dividends from the Company's subsidiary, Republic. Dividend payments from Republic are subject to legal and regulatory limitations. The ability of Republic to pay dividends is also subject to profitability, financial condition, capital expenditures and other cash flow requirements.

Liquidity

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

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

The Company's target and actual liquidity levels are determined by comparisons of the estimated repayment and marketability of interest-earning assets with projected future outflows of deposits and other liabilities. The Company's most liquid assets, comprised of cash and cash equivalents on the balance sheet, totaled \$56.8 million at June 30, 2013, compared to \$128.0 million at December 31, 2012. Loan maturities and repayments are another source of asset liquidity. At June 30, 2013, Republic estimated that more than \$35.0 million of loans would mature or repay in the six-month period ending December 31, 2013. Additionally, the majority of its investment securities are available to satisfy liquidity requirements if necessary. At June 30, 2013, the Company had outstanding commitments (including unused lines of credit and letters of credit) of \$99.5 million. Certificates of deposit scheduled to mature in one year totaled \$62.8 million at June 30, 2013. The Company anticipates that it will have sufficient funds available to meet its current commitments.

Daily funding requirements have historically been satisfied by generating core deposits and certificates of deposit with competitive rates, buying federal funds or utilizing the credit facilities of the Federal Home Loan Bank System ("FHLB"). The Company has established a line of credit with the FHLB of Pittsburgh with total borrowing capacity in the amount of \$299.2 million as of June 30, 2013. As of June 30, 2013 and December 31, 2012, the Company had no outstanding term borrowings with the FHLB. The Company had no short-term borrowings at both June 30, 2013 and December 31, 2012. The Company has also established a contingency line of credit of \$10.0 million with Atlantic Central Bankers Bank ("ACBB") to assist in managing its liquidity position. The Company had no amounts outstanding against the ACBB line of credit at both June 30, 2013 and December 31, 2012.

Investment Securities Portfolio

At June 30, 2013, the Company identified certain investment securities that were being held for indefinite periods of time, including securities that will be used as part of the Company's asset/liability management strategy and that may be sold in response to changes in interest rates, prepayments and similar factors. These securities are classified as available for sale and are intended to increase the flexibility of the Company's asset/liability management. Available for sale securities consist primarily of U.S Government Agency mortgage-backed securities (MBS), agency collateralized mortgage obligations (CMO), municipal securities, corporate bonds, asset-backed securities and pooled trust preferred securities (CDO). Available-for-sale securities totaled \$184.4 million and \$189.3 million as of June 30, 2013 and December 31, 2012, respectively. At June 30, 2013 and December 31, 2012, the portfolio had net unrealized losses of \$2.6 million and net unrealized gains of \$1.6 million, respectively.

Loan Portfolio

The Company's loan portfolio consists of secured and unsecured commercial loans including commercial real estate, construction loans, residential mortgages, automobile loans, home improvement loans, home equity loans and lines of credit, overdraft lines of credit and others. Commercial loans are primarily secured term loans made to small to medium-sized businesses and professionals for working capital, asset acquisition and other purposes. Commercial loans are originated as either fixed or variable rate loans with typical terms of 1 to 5 years. Republic's commercial loans typically range between \$250,000 and \$5,000,000 million but customers may borrow significantly larger amounts up to Republic's combined legal lending limit, which was approximately \$14.8 million at June 30, 2013. Individual customers may have several loans often secured by different collateral.

Credit Quality

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

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

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

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

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

	June 30, 2013	December 31, 2012
Loans accruing, but past due 90 days or more	\$-	\$202
Non-accrual loans	13,340	15,846
Total non-performing loans(1)	13,340	16,048
Other real estate owned	6,584	8,912
Total non-performing assets(1)	\$19,924	\$24,960
Non-performing loans as a percentage of total loans, net of unearned income(1)	2.09%	2.60%
Non-performing assets as a percentage of total assets	2.17%	2.52%

(1) Non-performing loans are comprised of (i) loans that are on non-accrual basis and (ii) accruing loans that are 90 days or more past due. Non-performing assets are composed of non-performing loans and other real estate owned.

Non-accrual loans decreased \$2.5 million to \$13.3 million at June 30, 2013, from \$15.8 million at December 31, 2012. This decrease was primarily the result of payoffs in the amount of \$1.7 million and charge-offs of \$1.2 million during the first six months of 2013. In addition to non-accrual loans, impaired loans also include loans that are currently performing but potential credit concerns with the borrowers' financial condition have caused management to have doubts as to the ability of such borrowers to continue to comply with present repayment terms. At June 30, 2013 and

December 31, 2012, all identified impaired loans are included in the preceding table, or are internally classified and individually evaluated for impairment in accordance with the guidance under ASC 310.

Republic had delinquent loans as follows: (i) 30 to 59 days past due, in the aggregate principal amount of \$5.5 million and \$1.1 million at June 30, 2013 and December 31, 2012, respectively; (ii) 60 to 89 days past due, at June 30, 2013 and December 31, 2012, in the aggregate principal amount of \$12.8 and \$27.8 million, respectively. Delinquent loans are currently in the process of collection and management believes they are supported by adequate collateral.

Other Real Estate Owned

The balance of other real estate owned decreased by \$2.3 million to \$6.6 million at June 30, 2013 from \$8.9 million at December 31, 2012 primarily due to the sale of one foreclosed property and writedowns on two foreclosed properties during the first six months of 2013.

The following table presents a reconciliation of other real estate owned for the six months ended June 30, 2013 and the year ended December 31, 2012:

(dollars in thousands)	June 30, 2013	December 31, 2012
Beginning Balance, January 1st	\$ 8,912	\$ 6,479
Additions	246	2,907
Valuation adjustments	(821)	(140)
Dispositions	(1,753)	(334)
Ending Balance	\$ 6,584	\$ 8,912

At June 30, 2013, the Company had no credit exposure to “highly leveraged transactions” as defined by the FDIC.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable losses inherent in the loan portfolio. The Company evaluates the need to establish an allowance against loan losses on a quarterly basis. When an increase in this allowance is necessary, a provision for loan losses is charged to earnings. The allowance for loan losses consists of three components. The first component is allocated to individually evaluated loans found to be impaired and is calculated in accordance with ASC 310. The second component is allocated to all other loans that are not individually identified as impaired pursuant to ASC 310-10 (“non-impaired loans”). This component is calculated for all non-impaired loans on a collective basis in accordance with ASC 450. The third component is an unallocated allowance to account for a level of imprecision in management’s estimation process.

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

Factors considered in the calculation of the allowance for non-impaired loans include several qualitative and quantitative factors such as historical loss experience, trends in delinquency and nonperforming loan balances, changes in risk composition and underwriting standards, experience and ability of management, and general economic

conditions along with other external factors. Historical loss experience is analyzed by reviewing charge-offs over a three year period to determine loss rates consistent with the loan categories depicted in the allowance for loan loss table below.

Prior to the first quarter of 2012, historical losses for all commercial loans secured by real estate were aggregated into one group for purposes of calculating a loss rate for loans collectively evaluated for impairment in the allowance for loan loss calculation. During the first quarter of 2012, management elected to disaggregate this grouping into five separate categories based on distinct risk factors to provide a more detailed estimate for the allowance calculation. This change resulted in a reduction of approximately \$2.6 million in the estimated allowance required for non-impaired loans in the first quarter of 2012 due to the application of lower loss rates to a larger segment of the commercial real estate portfolio with a lower risk profile.

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

An analysis of the allowance for loan losses for the six months ended June 30, 2013 and 2012, and the twelve months ended December 31, 2012 is as follows:

(dollars in thousands)	For the six months ended June 30, 2013	For the twelve months ended December 31, 2012	For the six months ended June 30, 2012		
Balance at beginning of period	\$ 9,542	\$ 12,050	\$ 12,050		
Charge-offs:					
Commercial real estate	409	1,582	766		
Construction and land development	55	1,004	921		
Commercial and industrial	361	1,304	760		
Owner occupied real estate	319	-	-		
Consumer and other	75	102	101		
Residential mortgage	-	-	-		
Total charge-offs	1,219	3,992	2,548		
Recoveries:					
Commercial real estate	54	-	-		
Construction and land development	-	105	105		
Commercial and industrial	5	-	-		
Owner occupied real estate	-	-	-		
Consumer and other	25	29	28		
Residential mortgage	-	-	-		
Total recoveries	84	134	133		
Net charge-offs	1,135	3,858	2,415		
Provision (credit) for loan losses	925	1,350	(250))	
Balance at end of period	\$ 9,332	\$ 9,542	\$ 9,385		
Average loans outstanding(1)	\$ 627,628	\$ 609,943	\$ 599,722		
As a percent of average loans:(1)					
Net charge-offs (annualized)	0.36	%	0.63	%	0.81
Provision (credit) for loan losses (annualized)	0.29	%	0.22	%	(0.08)
Allowance for loan losses	1.49	%	1.56	%	1.56
Allowance for loan losses to:					
Total loans, net of unearned income	1.46	%	1.54	%	1.55
Total non-performing loans	69.96	%	59.46	%	86.16

(1) Includes non-accruing loans.

The Company recorded a provision for loan losses of \$925,000 during the six month period ended June 30, 2013 compared to a negative (credit) provision for loan losses of \$250,000 for the six month period ended June 30, 2012. During the first six months of 2013, increases in allowances required for loans individually evaluated for impairment were primarily the result of changes in estimated collateral values driven by updated appraisals received during the period. The negative provision recorded in the first six months of 2012 was driven by a reduction in the allowance for

loan losses related to non-impaired loans evaluated collectively for impairment due to a change in the analysis of historical losses as described previously.

The allowance for loan losses as a percentage of non-performing loans (coverage ratio) was 69.96% at June 30, 2013, compared to 59.46% at December 31, 2012 and 86.16% at June 30, 2012. Total non-performing loans were \$13.3 million, \$16.0 million and \$10.9 million at June 30, 2013, December 31, 2012 and June 30, 2012, respectively.

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

Serious delinquency is often the first indicator of a potential charge-off. Reductions in appraised collateral values and deteriorating financial condition of borrowers and guarantors are factors considered when evaluating potential charge-offs. The likelihood of possible recoveries or improvements in a borrower's financial condition are also assessed when considering a charge-off. The Company recorded net charge-offs of \$1.1 million during the six month period ended June 30, 2013, compared to \$2.4 million during the six month period ended June 30, 2012.

Partial charge-offs of non-performing and impaired loans can significantly reduce the coverage ratio and other credit loss statistics due to the fact that the balance of the allowance for loan losses will be reduced while still carrying the remainder of a non-performing loan balance in the impaired loan category. The amount of non-performing loans for which partial charge-offs have been recorded amounted to \$12.3 million at June 30, 2013 compared to \$11.3 million at December 31, 2012. The Company's charge-off policy is reviewed on an annual basis and updated as necessary. During the six month period ended June 30, 2013, there were no changes made to this policy.

Recent Accounting Pronouncements

ASU 2013-02

In February 2013, the FASB issued ASU 2013-02, "Reporting of Amounts Reclassified Out of Comprehensive Income." The amendments in this ASU are intended to improve the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required that provide additional detail about those amounts. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is reclassified to a balance sheet account instead of directly to income or expense in the same reporting period. The ASU was effective for public entities for reporting periods beginning after December 15, 2012 and did not have a material impact on the Company's financial statements.

Effects of Inflation

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

ITEM 3: QUANTITATIVE AND QUALITATIVE INFORMATION ABOUT MARKET RISK

There has been no material change in the Company's assessment of its sensitivity to market risk since its presentation in the Annual Report on Form 10-K for the fiscal year ended December 31, 2012 filed with the SEC on March 15, 2013.

ITEM 4: CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

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

Changes in Internal Controls

The principal executive officer and principal financial officer also conducted an evaluation of the Company's internal control over financial reporting ("Internal Control") to determine whether any changes in Internal Control occurred during the quarter ended June 30, 2013 that have materially affected or which are reasonably likely to materially affect Internal Control. Based on that evaluation, there has been no such change during the quarter ended June 30, 2013.

Limitations on the Effectiveness of Controls

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

Significant risk factors could adversely affect the Company's business, financial condition and results of operation. Risk factors discussing these risks can be found in Part I, "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 and Form 10-Q for the quarter ended March 31, 2013. The risk factors in the Company's Annual Report on Form 10-K have not materially changed. You should carefully consider these risk factors. The risks described in the Company's Form 10-K and Form 10-Q are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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

Exhibit Number	Description	Location
3.1	Amended and Restated Articles of Incorporation of Republic First Bancorp, Inc.	Incorporated by reference to Form 8-K filed May 13, 2010
3.2	Amended and Restated By-Laws of Republic First Bancorp, Inc.	Incorporated by reference to Form S-1 filed April 23, 2010 (333-166286)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chairman and Chief Executive Officer of Republic First Bancorp, Inc.	<u>Filed herewith</u>
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of Republic First Bancorp, Inc.	<u>Filed herewith</u>
32.1	Section 1350 Certification of Harry D. Madonna	<u>Furnished herewith</u>
32.2	Section 1350 Certification of Frank A. Cavallaro	<u>Furnished herewith</u>
101	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012, (ii) Consolidated Statements of Income for the three and six months ended June 30, 2013 and 2012, (iii) Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2013 and 2012, (iv) Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012, (v) Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2013 and 2012, and (vi) Notes to Consolidated Financial Statements.	*

* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

SIGNATURES

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

REPUBLIC FIRST BANCORP, INC.

Date: August 12, 2013

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

Date: August 12, 2013

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