CITIGROUP INC
Form 424B2
May 21, 2018

The information in this preliminary pricing supplement is not complete and may be changed. A registration statement relating to these notes has been filed with the Securities and Exchange Commission. This preliminary pricing supplement and the accompanying product supplement, underlying supplement, prospectus supplement and prospectus are not an offer to sell these notes, nor are they soliciting an offer to buy these notes, in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED MAY 21, 2018

Pricing Supplement No. 2018—USNCH1168 to Product Supplement No. EA-04-06 dated April 7, 2017,

Underlying Supplement No. 6 dated April 7, 2017, Prospectus Supplement and Prospectus each dated April 7, 2017

Filed Pursuant to Rule 424(b)(2)

Registration Statement Nos. 333-216372 and 333-216372-01

Dated May-----, 2018

Citigroup Global Markets Holdings Inc. $---- Trigger Autocallable Contingent Yield Notes

Linked to the Least Performing of the S&P 500® Index and the EURO STOXX 50® Index Due On or About May 31, 2028

All payments due on the notes are fully and unconditionally guaranteed by Citigroup Inc.

Investment Description
The Trigger Autocallable Contingent Yield Notes (the "**notes**") are unsecured, unsubordinated debt obligations of Citigroup Global Markets Holdings Inc. (the "**issuer**"), guaranteed by Citigroup Inc. (the "**guarantor**"), linked to the **least performing** of the S&P 500® Index and the EURO STOXX 50® Index (each, an "**underlying**"). The notes will pay a contingent coupon on each quarterly coupon payment date if, **and only if**, the closing level of the least performing underlying on the related quarterly valuation date is greater than or equal to its coupon barrier. If the closing level of the least performing underlying on a quarterly valuation date is less than its coupon barrier, no contingent coupon will be paid on the related coupon payment date. Beginning approximately one year after issuance, if the closing level of the least performing underlying on a quarterly valuation date is greater than or equal to its initial underlying level, we will automatically call the notes and pay you the stated principal amount per note plus the contingent coupon for that valuation date, and no further amounts will be owed to you. At maturity, if the notes have not previously been automatically called, the amount you receive will depend on the final underlying level of the least performing underlying on the final valuation date. If the final underlying level of the least performing underlying on the final valuation date is greater than or equal to its downside threshold, you will receive the stated principal amount of your notes at maturity plus the final contingent coupon payment. However, if the notes have not been automatically called prior to maturity and the final underlying level of the least performing underlying on the final valuation date is less than its downside threshold, you will receive less than the stated principal amount of your notes at maturity, resulting in a loss that is proportionate to the decline in the closing level of the least performing underlying from the trade date to the final valuation date, up to a 100% loss of your investment. On each valuation date, the least performing underlying is the underlying with the lowest underlying return from the trade date to that valuation date. **Investing in the notes involves significant risks. You may lose a substantial portion or all of your initial investment. The stated payout on the notes is based <u>solely</u> on the performance of the least performing underlying. You will not**

benefit in any way from the performance of the better performing underlying. You will therefore be adversely affected if either underlying performs poorly, regardless of the performance of the other underlying. You will not receive dividends or other distributions paid on any stocks included in the underlyings or participate in any appreciation of either underlying. The contingent repayment of the stated principal amount applies only if you hold the notes to maturity or earlier automatic call. Any payment on the notes, including any repayment of the stated principal amount, is subject to the creditworthiness of the issuer and the guarantor and is not, either directly or indirectly, an obligation of any third party. If the issuer and the guarantor were to default on their payment obligations, you may not receive any amounts owed to you under the notes and you could lose your entire investment.

Features

q **Contingent Coupon** — We will pay you a contingent coupon on each quarterly coupon payment date if, **and only if,** the closing level of the least performing underlying on the related valuation date is greater than or equal to its coupon barrier. Otherwise, no contingent coupon will be paid for that quarter.

q **Automatic Call** — Beginning approximately one year after issuance, we will automatically call the notes and pay you the stated principal amount per note plus the contingent coupon for that valuation date if the closing level of the least performing underlying on a quarterly valuation date is greater than or equal to its initial underlying level. If the notes are not automatically called, investors may have full downside market exposure to the least performing underlying at maturity.

q **Downside Exposure with Contingent Repayment of Principal at Maturity** — If the notes are not automatically called prior to maturity and the final underlying level of the least performing underlying on the final valuation date is greater than or equal to its downside threshold, you will receive the stated principal amount of your notes at maturity plus the final contingent coupon payment. However, if the final underlying level of the least performing underlying on the final valuation date is less than its downside threshold, you will receive less than the stated principal amount of your notes at maturity, resulting in a loss that is proportionate to the decline in the closing level of the least performing underlying from the trade date to the final valuation date, up to a 100% loss of your investment. **Any payment on the notes is subject to the creditworthiness of the issuer and guarantor. If the issuer and the guarantor were to default on their obligations, you might not receive any amounts owed to you under the notes and you could lose your entire investment.**

Key Dates[1]	
Trade date	May 29, 2018
Settlement date	May 31, 2018
Valuation dates[2]	Quarterly, beginning on August 29, 2018 (See page PS-6)
Final valuation date[3]	May 25, 2028
Maturity date	May 31, 2028

[1] Expected

[2] See page PS-6 for additional details.

[3] See page PS-4 for additional details.

NOTICE TO INVESTORS: The notes are significantly riskier than conventional debt INSTRUMENTS. THE ISSUER IS NOT NECESSARILY OBLIGATED TO REPAY THE STATED PRINCIPAL AMOUNT OF THE NOTES AT MATURITY, AND the notes CAN have downside MARKET risk SIMILAR TO the LEAST PERFORMING UNDERLYING. This MARKET risk is in addition to the CREDIT risk INHERENT IN

PURCHASING A DEBT OBLIGATION OF CITIGROUP GLOBAL MARKETS HOLDINGS INC. THAT IS GUARANTEED BY CITIGROUP INC. You should not PURCHASE the notes if you do not understand or are not comfortable with the significant risks INVOLVED in INVESTING IN the notes.

YOU SHOULD CAREFULLY CONSIDER THE RISKS DESCRIBED UNDER ''SUMMARY RISK FACTORS'' BEGINNING ON PAGE PS-7 OF THIS PRICING SUPPLEMENT AND UNDER ''RISK FACTORS RELATING TO THE SECURITIES'' BEGINNING ON PAGE EA-6 OF THE ACCOMPANYING PRODUCT SUPPLEMENT BEFORE PURCHASING ANY NOTES. EVENTS RELATING TO ANY OF THOSE RISKS, OR OTHER RISKS AND UNCERTAINTIES, COULD ADVERSELY AFFECT THE MARKET VALUE OF, AND THE RETURN ON, YOUR NOTES. YOU MAY LOSE SOME OR ALL OF YOUR INITIAL INVESTMENT IN THE NOTES. THE NOTES WILL NOT BE LISTED ON ANY SECURITIES EXCHANGE AND MAY HAVE LIMITED OR NO LIQUIDITY.

Notes Offering

We are offering Trigger Autocallable Contingent Yield Notes Linked to the Least Performing of the S&P 500® Index and the EURO STOXX 50® Index. Any payment on the notes will be based on the performance of the least performing underlying. The initial underlying levels, coupon barriers and downside thresholds will be determined on the trade date. The notes are our unsecured, unsubordinated debt obligations, guaranteed by Citigroup Inc., and are offered for a minimum investment of 100 notes at the issue price described below.

Underlyings	Contingent Coupon Rate	Initial Underlying Levels	Coupon Barriers	Downside Thresholds	CUSIP/ISIN
S&P 500® Index (Ticker: SPX)	6.00% per annum		-----, which is 55% to 60% of the applicable initial underlying level (to be determined on the trade date)	-----, which is 55% to 60% of the applicable initial underlying level (to be determined on the trade date)	17326K437 / US17326K4379
EURO STOXX 50® Index (Ticker: SX5E)			-----, which is 55% to 60% of the applicable initial underlying level (to be determined on the trade date)	-----, which is 55% to 60% of the applicable initial underlying level (to be determined on the trade date)	

See "Additional Terms Specific to the Notes" in this pricing supplement. The notes will have the terms specified in the accompanying product supplement, prospectus supplement and prospectus, as supplemented by this pricing supplement.

Neither the Securities and Exchange Commission (the "**SEC**") nor any state securities commission has approved or disapproved of the notes or passed upon the accuracy or the adequacy of this pricing supplement or the accompanying product supplement, underlying supplement, prospectus supplement and prospectus. Any representation to the contrary is a criminal offense. The notes are not bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other governmental agency.

	Issue Price(1)	Underwriting Discount(2)	Proceeds to Issuer
Per note	$10.00	$0.35	$9.65
Total	$	$	$

(1) Citigroup Global Markets Holdings Inc. currently expects that the estimated value of the notes on the trade date will be at least $9.400, which will be less than the issue price. The estimated value of the notes is based on proprietary pricing models of Citigroup Global Markets Inc. ("**CGMI**") and our internal funding rate. It is not an indication of actual profit to CGMI or other of our affiliates, nor is it an indication of the price, if any, at which CGMI or any other person may be willing to buy the notes from you at any time after issuance. See "Valuation of the Notes" in this pricing supplement.

(2) The underwriting discount is $0.35 per note. CGMI, acting as principal, expects to purchase from Citigroup Global Markets Holdings Inc., and Citigroup Global Markets Holdings Inc. expects to sell to CGMI, the aggregate stated principal amount of the notes set forth above for $9.65 per note. UBS Financial Services Inc. ("**UBS**"), acting as agent for sales of the notes, expects to purchase from CGMI, and CGMI expects to sell to UBS, all of the notes for $9.65 per note. UBS will receive an underwriting discount of $0.35 for each note it sells in this offering. UBS proposes to offer the notes to the public at a price of $10.00 per note. For additional information on the distribution of the notes, see "Supplemental Plan of Distribution" in this pricing supplement. In addition to the underwriting discount, CGMI and its affiliates may profit from expected hedging activity related to this offering, even if the value of the notes declines. See "Use of Proceeds and Hedging" in the accompanying prospectus.

Citigroup Global Markets Inc. UBS Financial Services Inc.

Additional Terms Specific to the Notes

The terms of the notes are set forth in the accompanying product supplement, prospectus supplement and prospectus, as supplemented by this pricing supplement. The accompanying product supplement, prospectus supplement and prospectus contain important disclosures that are not repeated in this pricing supplement. For example, certain events may occur that could affect whether you receive a contingent coupon payment on a coupon payment date, whether the notes are automatically called prior to maturity and whether you are repaid the stated principal amount of your notes at maturity. These events and their consequences are described in the accompanying product supplement in the sections "Description of the Securities—Certain Additional Terms for Securities Linked to an Underlying Index—Consequences of a Market Disruption Event; Postponement of a Valuation Date" and "—Discontinuance or Material Modification of an Underlying Index," and not in this pricing supplement. The accompanying underlying supplement contains important disclosures regarding the underlyings that are not repeated in this pricing supplement. It is important that you read the accompanying product supplement, underlying supplement, prospectus supplement and prospectus together with this pricing supplement before you decide whether to invest in the notes. Certain terms used but not defined in this pricing supplement are defined in the accompanying product supplement.

You may access the accompanying product supplement, underlying supplement, prospectus supplement and prospectus on the SEC website at www.sec.gov as follows (or if such address has changed, by reviewing our filings for April 7, 2017 on the SEC website):

¨ Product Supplement No. EA-04-06 dated April 7, 2017:

https://www.sec.gov/Archives/edgar/data/200245/000095010317003412/dp74981_424b2-coba.htm

¨ Underlying Supplement No. 6 dated April 7, 2017:

https://www.sec.gov/Archives/edgar/data/200245/000095010317003405/dp74985_424b2-us6.htm

¨ Prospectus Supplement and Prospectus each dated April 7, 2017:

https://www.sec.gov/Archives/edgar/data/831001/000119312517116348/d370918d424b2.htm

You may revoke your offer to purchase the notes at any time prior to the time at which we accept such offer by notifying the applicable agent. We reserve the right to change the terms of, or reject any offer to purchase, the notes on or prior to the trade date. The applicable agent will notify you in the event of any material changes to the terms of the notes, and you will be asked to accept such changes in connection with your purchase of the notes. You may also choose to reject such changes, in which case the applicable agent may reject your offer to purchase the notes.
References to "Citigroup Global Markets Holdings Inc.," "Citigroup," "we," "our" and "us" refer to Citigroup Global Markets Holdings Inc. and not to any of its subsidiaries. References to "Citigroup Inc." refer to Citigroup Inc. and not to any of its subsidiaries. In this pricing supplement, "notes" refers to the Trigger Autocallable Contingent Yield Notes Linked to

the Least Performing of the S&P 500® Index and the EURO STOXX 50® Index that are offered hereby, unless the context otherwise requires.

This pricing supplement, together with the documents listed above, contains the terms of the notes and supersedes all other prior or contemporaneous oral statements as well as any other written materials including preliminary or indicative pricing terms, correspondence, trade ideas, structures for implementation, sample structures, brochures or other educational materials of ours. The description in this pricing supplement of the particular terms of the notes supplements, and, to the extent inconsistent with, replaces, the descriptions of the general terms and provisions of the debt securities set forth in the accompanying product supplement, prospectus supplement and prospectus. You should carefully consider, among other things, the matters set forth in "Summary Risk Factors" in this pricing supplement and "Risk Factors Relating to the Securities" in the accompanying product supplement, as the notes involve risks not associated with conventional debt securities. We urge you to consult your investment, legal, tax, accounting and other advisers before deciding to invest in the notes.

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Investor Suitability

The suitability considerations identified below are not exhaustive. Whether or not the notes are a suitable investment for you will depend on your individual circumstances, and you should reach an investment decision only after you and your investment, legal, tax, accounting and other advisors have carefully considered the suitability of an investment in the notes in light of your particular circumstances. You should also review "Summary Risk Factors" beginning on page PS-7 of this pricing supplement, "The S&P 500® Index" beginning on page PS-14 of this pricing supplement, "The EURO STOXX 50® Index" beginning on page PS-15 of this pricing supplement, "Risk Factors Relating to the Securities" beginning on page EA-6 of the accompanying product supplement, "Equity Index Descriptions— The S&P U.S. Indices" beginning on page 102 of the accompanying underlying supplement and "Equity Index Descriptions—The EURO STOXX 50® Index" beginning on page 23 of the accompanying underlying supplement.

The notes may be suitable for you if, among other considerations:

¨ You fully understand the risks inherent in an investment in the notes, including the risk of loss of your entire initial investment.

¨ You can tolerate a loss of all or a substantial portion of your initial investment and are willing to make an investment that may have the full downside market risk of an investment in the least performing underlying.

¨ You understand and accept the risks associated with each of the underlyings.

¨ You believe the closing level of each underlying is likely to be greater than or equal to its respective coupon barrier on the valuation dates, and, if the closing level of either underlying is not, you can tolerate receiving few or no contingent coupon payments over the term of the notes.

¨ You believe the closing level of each underlying will be greater than or equal to its downside threshold on the final valuation date, and, if the closing level of either underlying is below its downside threshold on the final valuation date, you can tolerate a loss of all or a substantial portion of your investment.

The notes may *not* be suitable for you if, among other considerations:

¨ You do not fully understand the risks inherent in an investment in the notes, including the risk of loss of your entire initial investment.

¨ You cannot tolerate the loss of all or a substantial portion of your initial investment, and you are not willing to make an investment that may have the full downside market risk of an investment in the least performing underlying.

¨ You do not understand or are not willing to accept the risks associated with each of the underlyings.

¨ You do not believe the closing level of each underlying is likely to be greater than or equal to its respective coupon barrier on the valuation dates, or you cannot tolerate receiving few or no contingent coupon payments over the term of the notes.

¨ You can tolerate fluctuations in the value of the notes prior to maturity that may be similar to or exceed the downside fluctuations in the level of the least performing underlying.

¨ You understand that your return will be based on the performance of the least performing underlying and you will not benefit from the performance of the other underlying.

¨ You are willing to hold notes that will be called on the earliest valuation date (beginning one year after issuance) on which the closing level of the least performing underlying is greater than or equal to its respective initial underlying level, and you are otherwise willing to hold such notes to maturity.

¨ You are willing to make an investment whose positive return is limited to the contingent coupon payments, regardless of the potential appreciation of the underlyings, which could be significant.

¨ You would be willing to invest in the notes if the coupon barriers and downside thresholds were set equal to the tops of the ranges indicated on the cover page of this pricing supplement (the actual coupon barriers and downside thresholds will be set on the trade date).

¨ You are willing to invest in the notes based on the contingent coupon rate indicated on the cover page of this pricing supplement.

¨ You are willing and able to hold the notes to maturity, and accept that there may be little or no secondary market for the notes and that any secondary market will depend in large part on the price, if any, at which CGMI is willing to purchase the notes.

¨ You believe the closing level of either underlying will be less than its respective downside threshold on the final valuation date, exposing you to the full downside performance of the least performing underlying.

¨ You require an investment designed to guarantee a full return of the stated principal amount at maturity.

¨ You cannot tolerate fluctuations in the value of the notes prior to maturity that may be similar to or exceed the downside fluctuations in the level of the least performing underlying.

¨ You are unwilling to accept that your return will be based on the performance of the least performing underlying, or you seek an investment based on the performance of a basket composed of the underlyings.

¨ You are unwilling to hold notes that will be called on the earliest valuation date (beginning one year after issuance) on which the closing level of the least performing underlying is greater than or equal to its respective initial underlying level, or you are otherwise unable or unwilling to hold such notes to maturity.

¨ You seek an investment that participates in the full appreciation of the underlyings and whose positive return is not limited to the contingent coupon payments.

¨ You would be unwilling to invest in the notes if the coupon barriers and downside

¨ You do not seek guaranteed current income from your investment and are willing to forgo dividends or any other distributions paid on the stocks included in the underlyings for the term of the notes.

¨ You are willing to assume the credit risk of Citigroup Global Markets Holdings Inc. and Citigroup Inc. for all payments under the notes, and understand that if Citigroup Global Markets Holdings Inc. and Citigroup Inc. default on their obligations, you might not receive any amounts due to you, including any repayment of the stated principal amount.

thresholds were set equal to the tops of the ranges indicated on the cover page of this pricing supplement (the actual coupon barriers and downside thresholds will be set on the trade date).

¨ You are unwilling to invest in the notes based on the contingent coupon rate indicated on the cover page of this pricing supplement.

¨ You seek an investment for which there will be an active secondary market.

¨ You seek guaranteed current income from this investment or prefer to receive the dividends and any other distributions paid on the stocks included in the underlyings for the term of the notes.

¨ You prefer the lower risk of conventional fixed income investments with comparable maturities and credit ratings.

¨ You are not willing to assume the credit risk of Citigroup Global Markets Holdings Inc. and Citigroup Inc. for all payments under the notes, including any repayment of the stated principal amount.

Indicative Terms

Issuer	Citigroup Global Markets Holdings Inc.
Guarantee	All payments due on the notes are fully and unconditionally guaranteed by Citigroup Inc.
Issue price	100% of the stated principal amount per note
Stated principal amount per note	$10.00 per note
Term	Approximately ten years, unless earlier automatically called
Trade date[1]	May 29, 2018
Settlement date[1]	May 31, 2018. See "Supplemental Plan of Distribution" in this pricing supplement for additional information.
Final valuation date[1, 2]	May 25, 2028
Maturity date[1]	May 31, 2028
Underlyings[1]	S&P 500® Index (Ticker: SPX) EURO STOXX 50® Index (Ticker: SX5E)
Automatic call feature	The notes will be automatically called if the closing level of the least performing underlying on any valuation date occurring on or after May 29, 2019 is greater than or equal to its initial underlying level. If the notes are automatically called, we will pay you on the applicable coupon payment date a cash payment per $10.00 stated principal amount of each note equal to the stated principal amount per note plus the contingent coupon for the applicable valuation date.
Valuation dates[1]	See "Valuation Dates/Coupon Payment Dates for the Offering of the Notes" on page PS-6.
Coupon payment dates	Three (3) business days following the applicable valuation date, except that the coupon payment date for the final valuation date is the maturity date. See "Valuation Dates/Coupon Payment Dates for the Offering of the Notes" on page PS-6.
Contingent coupon/contingent coupon rate	If the closing level of the least performing underlying on a quarterly valuation date is greater than or equal to its coupon barrier, we will make a contingent coupon payment with respect to that valuation date on the related coupon payment date. However, if the closing level of the least performing underlying on a quarterly valuation date is below its coupon barrier, no contingent coupon will be payable on the related coupon payment date.

Each contingent coupon payment will be in the amount of $0.15 for each $10.00 stated principal amount note (based on the per annum contingent coupon rate of 6.00%) and will be payable with respect to each valuation date on which the closing level of the least performing underlying on that valuation date is greater than or equal to its coupon barrier.

Contingent coupon payments on the notes are not guaranteed. We will not pay you the contingent coupon for any valuation date on

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[1] Expected. In the event that we make any changes to the expected trade date and settlement date, the valuation dates and maturity date may be changed to ensure that the stated term of the notes remains the same.

[2] Subject to postponement as described under “Description of the Securities—Certain Additional Terms for Securities Linked to an Underlying Index—Consequences of a Market Disruption Event; Postponement of a Valuation Date” in the accompanying product supplement.

which the closing level of least performing underlying on that valuation date is less than its coupon barrier.

If the notes are not automatically called prior to maturity and the final underlying level of the least performing underlying on the final valuation date is greater than or equal to its downside threshold, we will pay you the $10.00 stated principal amount plus the contingent coupon with respect to the final valuation date.

Payment at maturity (per $10.00 stated principal amount of notes)	**If the notes are not automatically called prior to maturity and the final underlying level of the least performing underlying on the final valuation date is less than its downside threshold,** we will pay you a cash payment on the maturity date that is less than your stated principal amount and may be zero, resulting in a loss that is proportionate to the negative underlying return, equal to: $10.00 × (1 + underlying return of the least performing underlying on the final valuation date) ***Accordingly, you may lose all or a substantial portion of your stated principal amount at maturity, depending on how significantly the least performing underlying declines.***
Least performing underlying	On each valuation date, including the final valuation date, the underlying with the lowest underlying return as of that valuation date.
Underlying return	For any underlying on any valuation date, calculated as follows:

$$\frac{\text{current underlying level} - \text{initial underlying level}}{\text{initial underlying level}}$$

Downside threshold	For any underlying, 55% to 60% of the applicable initial underlying level (to be determined on the trade date), as specified on the cover page of this pricing supplement.
Coupon barrier	For any underlying, 55% to 60% of the applicable initial underlying level (to be determined on the trade date), as specified on the cover page of this pricing supplement.
Initial underlying level	For any underlying, its closing level on the trade date, as specified on the cover page of this pricing supplement.
Current underlying level	For any underlying and any valuation date, the closing level of that underlying on that valuation date.
Final underlying level	For any underlying, its closing level on the final valuation date.

INVESTING IN THE NOTES INVOLVES SIGNIFICANT RISKS. YOU MAY LOSE A SUBSTANTIAL PORTION OR ALL OF YOUR INITIAL INVESTMENT. THE CONTINGENT REPAYMENT OF THE STATED PRINCIPAL AMOUNT APPLIES ONLY IF YOU HOLD THE NOTES TO MATURITY. ANY PAYMENT ON THE NOTES IS SUBJECT TO THE CREDITWORTHINESS OF THE ISSUER AND THE GUARANTOR. IF CITIGROUP GLOBAL MARKETS HOLDINGS INC. AND CITIGROUP INC. WERE TO DEFAULT ON THEIR OBLIGATIONS, YOU MIGHT NOT RECEIVE ANY AMOUNTS OWED TO YOU UNDER THE NOTES AND YOU COULD LOSE YOUR ENTIRE INVESTMENT.

Investment Timeline

Trade date	The closing level of each underlying (its respective initial underlying level) is observed, the coupon barrier and downside threshold for each underlying are determined. If the closing level of the least performing underlying on any quarterly valuation date is greater than or equal to its coupon barrier, we will pay you a contingent coupon on the related coupon payment date. However, if the closing level of the least performing underlying on any quarterly valuation date is below its coupon barrier, no coupon will be payable on the related coupon payment date.
Quarterly (autocallable after one year)	The notes will be automatically called if the closing level of the least performing underlying on any valuation date (beginning one year after issuance) is greater than or equal to its initial underlying level. If the notes are automatically called on any valuation date, we will pay the stated principal amount plus the applicable contingent coupon on the related coupon payment date. After the notes are automatically called, no further payments will be made on the notes.
Maturity date (if not previously automatically called)	If the notes are not automatically called prior to maturity, the final underlying level of each underlying is observed on the final valuation date. **If the final underlying level of the least performing underlying on the final valuation date is greater than or equal to its downside threshold**, we will pay you the $10.00 stated principal amount plus the contingent coupon with respect to the final valuation date. **If the final underlying level of the least performing underlying on the final valuation date is less than its downside threshold**, we will pay you a cash payment on the maturity date that is less than your stated principal amount and may be zero, resulting in a loss that is proportionate to the negative underlying return, equal to: $10.00 × (1 + underlying return of the least performing underlying on the final valuation date)

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Valuation Dates/Coupon Payment Dates for the Offering of the Notes

Valuation Dates[1]	**Coupon Payment Dates**
August 29, 2018*	September 4, 2018
November 29, 2018*	December 4, 2018
February 28, 2019*	March 5, 2019
May 29, 2019	June 3, 2019
August 29, 2019	September 4, 2019
November 29, 2019	December 4, 2019
February 28, 2020	March 4, 2020
May 29, 2020	June 3, 2020
August 28, 2020	September 2, 2020
November 30, 2020	December 3, 2020
February 26, 2021	March 3, 2021
May 28, 2021	June 3, 2021
August 31, 2021	September 3, 2021
November 29, 2021	December 2, 2021
February 28, 2022	March 3, 2022
May 31, 2022	June 3, 2022
August 30, 2022	September 2, 2022
November 29, 2022	December 2, 2022
February 28, 2023	March 3, 2023
May 30, 2023	June 2, 2023
August 29, 2023	September 1, 2023
November 29, 2023	December 4, 2023
February 29, 2024	March 5, 2024
May 29, 2024	June 3, 2024
August 29, 2024	September 4, 2024
November 29, 2024	December 4, 2024
February 28, 2025	March 5, 2025
May 29, 2025	June 3, 2025
August 29, 2025	September 4, 2025
November 28, 2025	December 3, 2025
February 27, 2026	March 4, 2026
May 29, 2026	June 3, 2026
August 28, 2026	September 2, 2026
November 30, 2026	December 3, 2026
February 26, 2027	March 3, 2027
May 28, 2027	June 3, 2027
August 31, 2027	September 3, 2027
November 29, 2027	December 2, 2027
February 29, 2028	March 3, 2028
May 25, 2028	May 31, 2028

*The notes are NOT automatically callable until the fourth valuation date, which is May 29, 2019.

[1] Subject to postponement as described under “Description of the Securities—Certain Additional Terms for Securities Linked to an Underlying Index—Consequences of a Market Disruption Event; Postponement of a Valuation Date” in the accompanying product supplement.

Summary Risk Factors

An investment in the notes is significantly riskier than an investment in conventional debt securities. The notes are subject to all of the risks associated with an investment in our conventional debt securities (guaranteed by Citigroup Inc.), including the risk that we and Citigroup Inc. may default on our obligations under the notes, and are also subject to risks associated with each underlying. Accordingly, the notes are suitable only for investors who are capable of understanding the complexities and risks of the notes. You should consult your own financial, tax and legal advisers as to the risks of an investment in the notes and the suitability of the notes in light of your particular circumstances.

The following is a summary of certain key risk factors for investors in the notes. You should read this summary together with the more detailed description of risks relating to an investment in the notes contained in the section "Risk Factors Relating to the Securities" beginning on page EA-6 in the accompanying product supplement. You should also carefully read the risk factors included in the accompanying prospectus supplement and in the documents incorporated by reference in the accompanying prospectus, including Citigroup Inc.'s most recent Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q, which describe risks relating to the business of Citigroup Inc. more generally.

¨ **You may lose some or all of your investment** — The notes differ from ordinary debt securities in that we will not necessarily repay the full stated principal amount of your notes at maturity. If the notes are not automatically called on any of the valuation dates (beginning one year after issuance) and the final underlying level of the least performing underlying on the final valuation date is less than its downside threshold, you will lose 1% of the stated principal amount of the notes for every 1% by which the final underlying level of the least performing underlying is less than its initial underlying level. There is no minimum payment at maturity on the notes, and you may lose up to all of your investment in the notes.

¨ **You will not receive any contingent coupon payment for any quarter in which the closing level of the least performing underlying on the related valuation date is less than its coupon barrier** — A contingent coupon payment will be made on a coupon payment date if and only if the closing level of the least performing underlying on the related valuation date is greater than or equal to its coupon barrier. If the closing level of the least performing underlying on any valuation date is less than its coupon barrier, you will not receive any contingent coupon payment on the related coupon payment date. If the closing level of the least performing underlying is below its coupon barrier on each valuation date, you will not receive any contingent coupon payments over the term of the notes.

¨ **The notes are subject to the risks of both of the underlyings and will be negatively affected if either of the underlyings performs poorly, even if the other underlying performs well** — You are subject to risks associated with both of the underlyings. If either of the underlyings performs poorly, you will be negatively affected, even if the other underlying performs well. The notes are not linked to a basket composed of the underlyings, where the better performance of one could ameliorate the poor performance of the other. Instead, you are subject to the full risks of whichever of the underlyings is the least performing underlying on each valuation date. Furthermore, the risk that you will not receive the coupon and that you will lose some or all of your initial investment in the notes is greater if you invest in the notes as opposed to notes that are linked to the performance of a single underlying if their terms are otherwise substantially similar.

You will not benefit in any way from the performance of the better performing underlying — The return on the notes depends solely on the performance of the least performing underlying, and you will not benefit in any way from the performance of the better performing underlying. The notes may underperform a similar investment in both of the underlyings or a similar alternative investment linked to a basket composed of the underlyings, since in either such case the performance of the better performing underlying would be blended with the performance of the least performing underlying, resulting in a better return than the return of the least performing underlying.

You will be subject to risks relating to the relationship between the underlyings — It is preferable from your perspective for the underlyings to be correlated with each other, in the sense that they tend to increase or decrease at similar times and by similar magnitudes. By investing in the notes, you assume the risk that the underlyings will not exhibit this relationship. The less correlated the underlyings, the more likely it is that either one of the underlyings will perform poorly over the term of the notes. All that is necessary for the notes to perform poorly is for one of the underlyings to perform poorly; the performance of the underlying that is not the least performing underlying is not relevant to your return on the notes. It is impossible to predict what the relationship between the underlyings will be over the term of the notes. **The S&P 500® Index represents large capitalization stocks in the United States and the EURO STOXX 50® Index large capitalization stocks in the Eurozone. Accordingly, the underlyings represent markets that differ in significant ways and, therefore, may not be correlated with each other.**

Higher contingent coupon rates are associated with greater risk — The notes offer contingent coupon payments at an annualized rate that, if all are paid, would produce a yield that is generally higher than the yield on our conventional debt securities of the same maturity. This higher potential yield is associated with greater levels of expected risk as of the trade date for the notes, including the risks that you may not receive a contingent coupon payment on one or more, or any, coupon payment dates, the notes will not be automatically called and the amount you receive at maturity may be significantly less than the stated principal amount of your notes and may be zero. The volatility of and the correlation between the underlyings are important factors affecting these risks. Greater expected volatility of, and lower expected correlation between, the underlyings as of the trade date may result in a higher contingent coupon rate, but would also represent a greater expected likelihood as of the trade date that (i) the closing level of the least performing underlying will be less than the applicable coupon barrier on one or more valuation dates, such that you will not receive one or more, or any, contingent coupon payments during the term of the notes, (ii) the closing level of the least performing underlying will be less than the applicable initial underlying level on each valuation date, such that the notes are not automatically called and (iii) the closing level of the least

performing underlying will be less than the applicable downside threshold on the final valuation date, such that you will not be repaid the stated principal amount of your notes at maturity.

¨ **An investment in the notes may be more risky than an investment in notes with a shorter term.** The notes have a term of ten years, subject to our right to automatically call the notes beginning one year after the date of issuance of the notes. By purchasing notes with a relatively long term, you will bear greater exposure to fluctuations in interest rates than if you purchased a note with a shorter term. In particular, you may be negatively affected if interest rates begin to rise, because the likelihood that we will redeem your notes will decrease and the interest rate on the notes may be less than the amount of interest you could earn on other investments with a similar level of risk available at such time. In addition, if you tried to sell your notes at such time, the value of your notes in any secondary market transaction would also be adversely affected.

¨ **You may not be adequately compensated for assuming the downside risk of the least performing underlying** — The potential contingent coupon payments on the notes are the compensation you receive for assuming the downside risk of the least performing underlying, as well as all the other risks of the notes. That compensation is effectively "at risk" and may, therefore, be less than you currently anticipate. First, the actual yield you realize on the notes could be lower than you anticipate because the coupon is "contingent" and you may not receive a contingent coupon payment on one or more, or any, of the coupon payment dates. Second, the contingent coupon payments are the compensation you receive not only for the downside risk of the least performing underlying, but also for all of the other risks of the notes, including the risk that the notes may be called prior to maturity, interest rate risk and our and Citigroup Inc.'s credit risk. If those other risks increase or are otherwise greater than you currently anticipate, the contingent coupon payments may turn out to be inadequate to compensate you for all the risks of the notes, including the downside risk of the least performing underlying.

¨ **The notes offer downside exposure to the least performing underlying, but no upside exposure to either underlying** — You will not participate in any appreciation in the level of the underlyings over the term of the notes. Consequently, your return on the notes will be limited to the contingent coupon payments you receive, if any, and may be significantly less than the return on the underlyings over the term of the notes. In addition, you will not receive any dividends or other distributions or have any other rights with respect to the underlyings or the stocks included in the underlyings.

¨ **The performance of the notes will depend on the closing levels of the underlyings solely on the relevant valuation dates, which makes the notes particularly sensitive to the volatility of the underlyings** — Whether the contingent coupon will be paid for any given quarter will depend on the closing levels of the underlyings solely on the applicable quarterly valuation dates, regardless of the closing levels of the underlyings on other days during the term of the notes. If the notes are not automatically called, what you receive at maturity will depend solely on the closing level of the least performing underlying on the final valuation date, and not on any other day during the term of the notes. Because the performance of the notes depends on the closing levels of the underlyings on a limited number of dates, the notes will be particularly sensitive to volatility in the closing levels of the underlyings. You should understand that both of the underlyings have historically been highly volatile.

¨ **Investing in the notes is not equivalent to investing in either underlying or the stocks that constitute either underlying** — You will not have voting rights, rights to receive any dividends or other distributions or any other rights

with respect to any of the stocks that constitute the underlyings. It is important to understand that, for purposes of measuring the performance of the underlyings, the levels used will not reflect the receipt or reinvestment of dividends or distributions on the stocks that constitute either of the underlyings. Dividend or distribution yield on the stocks that constitute the underlyings would be expected to represent a significant portion of the overall return on a direct investment in the stocks that constitute the underlyings, but will not be reflected in the performance of either of the underlyings as measured for purposes of the notes (except to the extent that dividends and distributions reduce the levels of the underlyings).

¨ **The notes are subject to the credit risk of Citigroup Global Markets Holdings Inc. and Citigroup Inc.** — Any payment on the notes will be made by Citigroup Global Markets Holdings Inc. and is guaranteed by Citigroup Inc., and therefore is subject to the credit risk of both Citigroup Global Markets Holdings Inc. and Citigroup Inc. If we default on our obligations under the notes and Citigroup Inc. defaults on its guarantee obligations, you may not receive any payments that become due under the notes. As a result, the value of the notes prior to maturity will be affected by changes in the market's view of our and Citigroup Inc.'s creditworthiness. Any decline, or anticipated decline, in either of our or Citigroup Inc.'s credit ratings or increase, or anticipated increase, in the credit spreads charged by the market for taking either of our or Citigroup Inc.'s credit risk is likely to adversely affect the value of the notes.

¨ **The notes may be automatically called prior to maturity** — Beginning one year after issuance, on any valuation date occurring quarterly during the term of the notes, the notes will be automatically called if the closing level of the least performing underlying on that valuation date is greater than or equal to its respective initial underlying level. Thus, the term of the notes may be limited to as short as one year. If the notes are automatically called prior to maturity, you may not be able to reinvest your funds in another investment that provides a similar yield with a similar level of risk. Generally, the longer the notes are outstanding, the less likely it is that they will be automatically called due to the decline in the levels of the underlyings and the shorter time remaining for the levels of underlyings to recover.

¨ **The notes will not be listed on a securities exchange and you may not be able to sell them prior to maturity** — The notes will not be listed on any securities exchange. Therefore, there may be little or no secondary market for the notes. CGMI currently intends to make a secondary market in relation to the notes and to provide an indicative bid price for the notes on a daily basis. Any indicative bid price for the notes provided by CGMI will be determined in CGMI's sole discretion, taking into account prevailing market conditions and other relevant factors, and will not be a representation by CGMI that the notes can be sold at that price, or at all. CGMI may suspend or terminate making a market and providing indicative bid prices without notice, at any time and for any reason. If CGMI suspends or

terminates making a market, there may be no secondary market at all for the notes because it is likely that CGMI will be the only broker-dealer that is willing to buy your notes prior to maturity. Accordingly, an investor must be prepared to hold the notes until maturity.

¨ **The probability that the least performing underlying will fall below the coupon barrier on any valuation date or the downside threshold on the final valuation date will depend in part on the volatility of, and correlation between, the underlyings** — "Volatility" refers to the frequency and magnitude of changes in the level of the underlyings. "Correlation" refers to the extent to which the underlyings tend to increase or decrease at similar times and by similar magnitudes. In general, the greater the volatility of the underlyings, and the lower the correlation between the underlyings, the greater the probability that one or the other of the underlyings will experience a large decline over the term of the notes and fall below its respective coupon barrier on one, or more, quarterly valuation dates and/or below its respective downside threshold on the final valuation date. The underlyings have historically experienced significant volatility, and as discussed above, the underlyings represent markets that differ in significant ways and therefore may not be correlated. As a result, there is a significant risk that one or the other of the underlyings will fall below its respective coupon barrier on one or more valuation dates, such that you will not receive one or more contingent coupon payments, and that one or the other of the underlyings will fall below its respective downside threshold on the final valuation date, such that you will incur a significant loss on your investment in the notes. The terms of the notes are set, in part, based on expectations about the volatility of, and correlation between, the underlyings as of the trade date. If expectations about the volatility of, and correlation between, the underlyings change over the term of the notes, the value of the notes may be adversely affected, and if the actual volatility of the underlyings prove to be greater than initially expected, or if the actual correlation between the underlyings proves to be lower than initially expected, the notes may prove to be riskier than expected on the trade date.

¨ **The estimated value of the notes on the trade date, based on CGMI's proprietary pricing models and our internal funding rate, will be less than the issue price** — The difference is attributable to certain costs associated with selling, structuring and hedging the notes that are included in the issue price. These costs include (i) the underwriting discount paid in connection with the offering of the notes, (ii) hedging and other costs incurred by us and our affiliates in connection with the offering of the notes and (iii) the expected profit (which may be more or less than actual profit) to CGMI or other of our affiliates in connection with hedging our obligations under the notes. These costs adversely affect the economic terms of the notes because, if they were lower, the economic terms of the notes would be more favorable to you. The economic terms of the notes are also likely to be adversely affected by the use of our internal funding rate, rather than our secondary market rate, to price the notes. See "The estimated value of the notes would be lower if it were calculated based on our secondary market rate" below.

¨ **The estimated value of the notes was determined for us by our affiliate using proprietary pricing models** — CGMI derived the estimated value disclosed on the cover page of this pricing supplement from its proprietary pricing models. In doing so, it may have made discretionary judgments about the inputs to its models, such as the volatility of and correlation between the underlyings, dividend yields on the stocks that constitute the underlyings and interest rates. CGMI's views on these inputs may differ from your or others' views, and as an underwriter in this offering, CGMI's interests may conflict with yours. Both the models and the inputs to the models may prove to be wrong and therefore not an accurate reflection of the value of the notes. Moreover, the estimated value of the notes set forth on the cover page of this pricing supplement may differ from the value that we or our affiliates may determine for the notes for other purposes, including for accounting purposes. You should not invest in the notes because of the estimated value of the notes. Instead, you should be willing to hold the notes to maturity irrespective of the initial

estimated value.

¨ **The estimated value of the notes would be lower if it were calculated based on our secondary market rate** — The estimated value of the notes included in this pricing supplement is calculated based on our internal funding rate, which is the rate at which we are willing to borrow funds through the issuance of the notes. Our internal funding rate is generally lower than our secondary market rate, which is the rate that CGMI will use in determining the value of the notes for purposes of any purchases of the notes from you in the secondary market. If the estimated value included in this pricing supplement were based on our secondary market rate, rather than our internal funding rate, it would likely be lower. We determine our internal funding rate based on factors such as the costs associated with the notes, which are generally higher than the costs associated with conventional debt securities, and our liquidity needs and preferences. Our internal funding rate is not the same as the contingent coupon rate that is payable on the notes.

Because there is not an active market for traded instruments referencing our outstanding debt obligations, CGMI determines our secondary market rate based on the market price of traded instruments referencing the debt obligations of Citigroup Inc., our parent company and the guarantor of all payments due on the notes, but subject to adjustments that CGMI makes in its sole discretion. As a result, our secondary market rate is not a market-determined measure of our creditworthiness, but rather reflects the market's perception of our parent company's creditworthiness as adjusted for discretionary factors such as CGMI's preferences with respect to purchasing the notes prior to maturity.

¨ **The estimated value of the notes is not an indication of the price, if any, at which CGMI or any other person may be willing to buy the notes from you in the secondary market** — Any such secondary market price will fluctuate over the term of the notes based on the market and other factors described in the next risk factor. Moreover, unlike the estimated value included in this pricing supplement, any value of the notes determined for purposes of a secondary market transaction will be based on our secondary market rate, which will likely result in a lower value for the notes than if our internal funding rate were used. In addition, any secondary market price for the notes will be reduced by a bid-ask spread, which may vary depending on the aggregate stated principal amount of the notes to be purchased in the secondary market transaction, and the expected cost of unwinding related hedging transactions. As a result, it is likely that any secondary market price for the notes will be less than the issue price.

¨ **The value of the notes prior to maturity will fluctuate based on many unpredictable factors** — As described under "Valuation of the Notes" below, the payout on the notes could be replicated by a hypothetical package of financial instruments consisting of a fixed-income bond and one or more derivative instruments. As a result, the factors that influence the values of fixed-income bonds and

derivative instruments will also influence the terms of the notes at issuance and the value of the notes prior to maturity. Accordingly, the value of your notes prior to maturity will fluctuate based on the level and volatility of the underlyings and a number of other factors, including the price and volatility of the stocks that constitute the underlyings, the correlation between the underlyings, dividend yields on the stocks that constitute the underlyings, interest rates generally, the volatility of the exchange rate between the U.S. dollar and the euro, the correlation between that exchange rate and the level of the EURO STOXX 50® Index, the time remaining to maturity and our and Citigroup Inc.'s creditworthiness, as reflected in our secondary market rate. Changes in the levels of the underlyings may not result in a comparable change in the value of your notes. You should understand that the value of your notes at any time prior to maturity may be significantly less than the issue price. The stated payout from the issuer only applies if you hold the notes to maturity or earlier automatic call, as applicable.

¨ **Immediately following issuance, any secondary market bid price provided by CGMI, and the value that will be indicated on any brokerage account statements prepared by CGMI or its affiliates, will reflect a temporary upward adjustment** — The amount of this temporary upward adjustment will decline to zero over the temporary adjustment period. See "Valuation of the Notes" in this pricing supplement.

¨ **The EURO STOXX 50® Index is subject to risks associated with non-U.S. markets.** Investments in securities linked to the value of non-U.S. stocks involve risks associated with the securities markets in those countries, including risks of volatility in those markets, governmental intervention in those markets and cross-shareholdings in companies in certain countries. Also, there is generally less publicly available information about companies in some of these jurisdictions than about U.S. companies that are subject to the reporting requirements of the SEC. Further, non-U.S. companies are generally subject to accounting, auditing and financial reporting standards and requirements and securities trading rules that are different from those applicable to U.S. reporting companies. The prices of securities in foreign markets may be affected by political, economic, financial and social factors in those countries, or global regions, including changes in government, economic and fiscal policies and currency exchange laws. Moreover, the economies in such countries may differ favorably or unfavorably from the economy of the United States in such respects as growth of gross national product, rate of inflation, capital reinvestment, resources and self-sufficiency.

¨ **The performance of the EURO STOXX 50® Index will not be adjusted for changes in the exchange rate between the euro and the U.S. dollar —** The EURO STOXX 50® Index is composed of stocks traded in euro, the value of which may be subject to a high degree of fluctuation relative to the U.S. dollar. However, the performance of the EURO STOXX 50® Index and the value of your notes will not be adjusted for exchange rate fluctuations. If the euro appreciates relative to the U.S. dollar over the term of the notes, the performance of the EURO STOXX 50® Index as measured for purposes of the notes will be less than it would have been if it offered exposure to that appreciation in addition to the change in the prices of the underlying stocks.

¨ **Our offering of the notes is not a recommendation of either underlying** — The fact that we are offering the notes does not mean that we believe that investing in an instrument linked to the least performing underlying is likely to achieve favorable returns. In fact, as we are part of a global financial institution, our affiliates may have positions (including short positions) in the stocks that constitute the underlyings or in instruments related to the underlyings or the stocks that constitute the underlyings, and may publish research or express opinions, that in each case are inconsistent with an investment linked to the underlyings. These and other activities of our affiliates may affect the

levels of the underlyings in a way that has a negative impact on your interests as a holder of the notes.

¨ **Our affiliates, or UBS or its affiliates, may publish research, express opinions or provide recommendations that are inconsistent with investing in or holding the notes** — Any such research, opinions or recommendations could affect the closing levels of the underlyings and the value of the notes. Our affiliates, and UBS and its affiliates, publish research from time to time on financial markets and other matters that may influence the value of the notes, or express opinions or provide recommendations that may be inconsistent with purchasing or holding the notes. Any research, opinions or recommendations expressed by our affiliates or by UBS or its affiliates may not be consistent with each other and may be modified from time to time without notice. These and other activities of our affiliates or UBS or its affiliates may adversely affect the levels of the underlyings and may have a negative impact on your interests as a holder of the notes. Investors should make their own independent investigation of the merits of investing in the notes and the underlyings to which the notes are linked.

¨ **Trading and other transactions by our affiliates, or by UBS or its affiliates, in the equity and equity derivative markets may impair the value of the notes** — We expect to hedge our exposure under the notes through CGMI or other of our affiliates, who will likely enter into equity and/or equity derivative transactions, such as over-the-counter options or exchange-traded instruments, relating to the underlyings or the stocks included in the underlyings and may adjust such positions during the term of the notes. It is possible that our affiliates could receive substantial returns from these hedging activities while the value of the notes declines. Our affiliates and UBS and its affiliates may also engage in trading in instruments linked to the underlyings on a regular basis as part of their respective general broker-dealer and other businesses, for proprietary accounts, for other accounts under management or to facilitate transactions for customers, including block transactions. Such trading and hedging activities may affect the levels of the underlyings and reduce the return on your investment in the notes. Our affiliates or UBS or its affiliates may also issue or underwrite other securities or financial or derivative instruments with returns linked or related to the underlyings. By introducing competing products into the marketplace in this manner, our affiliates or UBS or its affiliates could adversely affect the value of the notes. Any of the foregoing activities described in this paragraph may reflect trading strategies that differ from, or are in direct opposition to, investors' trading and investment strategies relating to the notes.

¨ **Our affiliates, or UBS or its affiliates, may have economic interests that are adverse to yours as a result of their respective business activities** — Our affiliates or UBS or its affiliates may currently or from time to time engage in business with the issuers of the stocks that constitute the underlyings, including extending loans to, making equity investments in or providing advisory services to such issuers. In the course of this business, our affiliates or UBS or its affiliates may acquire non-public information about those issuers, which they will not disclose to you. Moreover, if any of our affiliates or UBS or any of its affiliates is or becomes a creditor of any such issuer, they may exercise any remedies against that issuer that are available to them without regard to your interests.

¨ **The calculation agent, which is an affiliate of ours, will make important determinations with respect to the notes** — If certain events occur, such as market disruption events or the discontinuance of an underlying, CGMI, as calculation agent, will be required to make discretionary judgments that could significantly affect the payments on the notes. Such judgments could include, among other things:

¨ determining whether a market disruption event has occurred with respect to an underlying;

¨ if a market disruption event occurs on any valuation date with respect to an underlying, determining whether to postpone the valuation date;

¨ determining the levels of the underlyings if the levels of the underlyings are not otherwise available or a market disruption event has occurred; and

¨ selecting a successor underlying or performing an alternative calculation of the level of an underlying if an underlying is discontinued or materially modified (see "Description of the Securities—Certain Additional Terms for Securities Linked to an Underlying Index—Discontinuance or Material Modification of an Underlying Index" in the accompanying product supplement).

In making these judgments, the calculation agent's interests as an affiliate of ours could be adverse to your interests as a holder of the notes.

¨ **Adjustments to either underlying may affect the value of your notes** — S&P Dow Jones Indices LLC, as publisher of the S&P 500® Index, or STOXX Limited, as publisher of the EURO STOXX 50® Index, may add, delete or substitute the stocks that constitute either underlying or make other methodological changes that could affect the level of either underlying. S&P Dow Jones Indices LLC or STOXX Limited may discontinue or suspend calculation or publication of either underlying at any time without regard to your interests as holders of the notes.

¨ **The U.S. federal tax consequences of an investment in the notes are unclear.** There is no direct legal authority regarding the proper U.S. federal tax treatment of the notes, and we do not plan to request a ruling from the Internal Revenue Service (the "IRS"). Consequently, significant aspects of the tax treatment of the notes are uncertain, and the IRS or a court might not agree with the treatment of the notes as described in "United States Federal Tax Considerations" below. If the IRS were successful in asserting an alternative treatment, the tax consequences of

ownership and disposition of the notes might be materially and adversely affected. Moreover, as described in the accompanying product supplement under "United States Federal Tax Considerations," in 2007 the U.S. Treasury Department and the IRS released a notice requesting comments on various issues regarding the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. While it is not clear whether the notes would be viewed as similar to the typical prepaid forward contract described in the notice, it is possible that any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the notes, including the character and timing of income or loss recognized by U.S. investors, possibly with retroactive effect. You should read carefully the discussion under "United States Federal Tax Considerations" and "Risk Factors Relating to the Securities" in the accompanying product supplement and "United States Federal Tax Considerations" in this pricing supplement. You should also consult your tax adviser regarding the U.S. federal tax consequences of an investment in the notes, as well as tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

Non-U.S. investors should note that persons having withholding responsibility in respect of the notes may withhold on any coupon payment paid to a non-U.S. investor, generally at a rate of 30%. To the extent that we have withholding responsibility in respect of the notes, we intend to so withhold.

In addition, Section 871(m) of the Internal Revenue Code of 1986, as amended (the "Code"), imposes a withholding tax of up to 30% on "dividend equivalents" paid or deemed paid to non-U.S. investors in respect of certain financial instruments linked to U.S. equities. In light of Treasury regulations, as modified by an IRS notice, that provide a general exemption for financial instruments issued in 2018 that do not have a "delta" of one, as of the date of this preliminary pricing supplement the notes should not be subject to withholding under Section 871(m). However, information about the application of Section 871(m) to the notes will be updated in the final pricing supplement. Moreover, the IRS could challenge a conclusion that the notes should not be subject to withholding under Section 871(m).

We will not be required to pay any additional amounts with respect to amounts withheld.

Hypothetical Examples
Hypothetical terms only. Actual terms may vary. See the cover page for actual offering terms.

The examples below illustrate the hypothetical payment upon automatic call or at maturity for a $10.00 stated principal amount note with the following assumptions* (the actual terms of the notes will be determined on the trade date; amounts may have been rounded for ease of reference):

- Stated Principal Amount: $10
- Term: 10 years, unless earlier automatically called
- Hypothetical Initial Underlying Levels:
  - S&P 500® Index: 2,700.00
  - EURO STOXX 50® Index: 3,600.00
- Contingent Coupon Rate: 6.00% per annum (or 1.50% per quarter)
- Quarterly Contingent Coupon Payment: $0.15 per quarter per note
- Valuation Dates: Quarterly, automatically callable after approximately one year, as set forth on page PS-6 of this pricing supplement
- Hypothetical Coupon Barriers:
  - S&P 500® Index: 1,485.00, which is 55% of its hypothetical initial underlying level
  - EURO STOXX 50® Index: 1,980.00, which is 55% of its hypothetical initial underlying level
- Hypothetical Downside Thresholds:
  - S&P 500® Index: 1,485.00, which is 55% of its hypothetical initial underlying level

- o EURO STOXX 50® Index: 1,980.00, which is 55% of its hypothetical initial underlying level

**The hypothetical initial underlying levels, coupon barriers and downside thresholds may not represent the actual initial underlying levels, coupon barriers and downside thresholds, respectively, applicable to the underlyings. The actual initial underlying levels, coupon barriers and downside thresholds will be determined on the trade date.*

Example 1 — Notes are automatically called on the fourth valuation date.

Date	**Closing Level of the Underlying**		**Payment (per note)**
	S&P 500® Index	**EURO STOXX 50® Index**	
First Valuation Date	2,000.00 **(at or above** coupon barrier)	2,550.00 (**at or above** coupon barrier)*	$0.15 (contingent coupon — not callable)
Second Valuation Date	2,500.00 **(at or above** coupon barrier)	2,750.00 (**at or above** coupon barrier)*	$0.15 (contingent coupon — not callable)
Third Valuation Date	2,250.00 **(at or above** coupon barrier)	2,800.00 (**at or above** coupon barrier)*	$0.15 (contingent coupon — not callable)
Fourth Valuation Date	2,950.00 **(at or above** coupon barrier and initial underlying level)*	4,000.00 (**at or above** coupon barrier and initial underlying level)	$10.15 (settlement amount)
		Total Payment:	$10.60 (6.00% total return)

* Denotes least performing underlying for the applicable valuation date

The least performing underlying closes above its respective coupon barrier on the first three valuation dates and therefore a contingent coupon is paid on each of the first three coupon payment dates. On the fourth valuation date (which is approximately one year after the trade date and is the first valuation date on which the notes are subject to potential automatic call), the least performing underlying on the fourth valuation date closes above its respective initial underlying level, and the notes are automatically called on the related coupon payment date. You will receive on the coupon payment date a total of $10.15 per note, reflecting the $10.00 stated principal amount *plus* the applicable contingent coupon. When added to the total contingent coupon payments of $0.45 received in respect of the prior valuation dates, you would have been paid a total of $10.60 per note for a 6.00% total return on the notes. No further amount would be owed to you under the notes, and you would not participate in the appreciation of the underlyings.

Example 2 — Notes are NOT automatically called and the final underlying level of the least performing underlying on the final valuation date is at or above its respective downside threshold.

Date	Closing Level of the Underlying S&P 500® Index	EURO STOXX 50® Index	Payment (per note)
First Valuation Date	2,500.00 (**at or above** coupon barrier)	2,600.00 (**at or above** coupon barrier)*	$0.15 (contingent coupon — not callable)
Second Valuation Date	2,350.00 (**at or above** coupon barrier)	2,550.00 (**at or above** coupon barrier)*	$0.15 (contingent coupon — not callable)
Third to Thirty-Ninth Valuation Dates	various (**all at or above** coupon barrier; **all below** initial underlying level)	various (**all below** coupon barrier and initial underlying level)*	$0.00 (not callable)
Final Valuation Date	2,350.00 (**at or above** downside threshold)	2,700.00 (**at or above** downside threshold)*	$10.15
		Total Payment:	$10.45 (4.50% total return)

* Denotes least performing underlying for the applicable valuation date(s)

The least performing underlying on each of the first two valuation dates closes above its respective coupon barrier on the first two valuation dates and therefore a contingent coupon is paid on each of the first two coupon payment dates. On each of the third to thirty-ninth valuation dates, the least performing underlying closes below its coupon barrier. Therefore, no contingent coupon is paid on any related coupon payment date. On the final valuation date, the least performing underlying on the final valuation date closes above its respective downside threshold. Therefore, at maturity, you would receive a total of $10.15 per note, reflecting the $10.00 stated principal amount *plus* the applicable contingent coupon. When added to the total contingent coupon payments of $0.30 received in respect of the prior valuation dates, you would have been paid a total of $10.45 per note for a 4.50% total return on the notes over ten years.

Example 3 — Notes are NOT automatically called and the final underlying level of the least performing underlying on the final valuation date is below its respective downside threshold.

Date	Closing Level of the Underlying		Payment (per note)
	S&P 500® Index	EURO STOXX 50® Index	
First to Thirty-Ninth Valuation Dates	Various (**all below** coupon barrier and initial underlying level)	Various (**all below** coupon barrier and initial underlying level)*	$0 (not callable)

Final Valuation Date	2,550.00 (**at or above** downside threshold)	1,080.00 (**below** downside threshold)*	$10.00 × [1 + underlying return of the least performing underlying on the final valuation date] = $10.00 × [1 + -70.00%] = $10.00 × 0.30 = $3.00 (payment at maturity)
		Total Payment:	$3.00 (-70.00% total return)

* Denotes least performing underlying for the applicable valuation date(s)

The least performing underlying on each valuation date closes below its coupon barrier, and as a result no contingent coupon is paid on any coupon payment date during the term of the notes. On the final valuation date, the least performing underlying on the final valuation date closes below its respective downside threshold. Therefore, at maturity, investors are exposed to the downside performance of the least performing underlying and you will receive $3.00 per note, which reflects the percentage decrease of the least performing underlying on the final valuation date from the trade date to the final valuation date.

The S&P 500® Index

The S&P 500® Index consists of 500 companies selected to provide a performance benchmark for the large capitalization segment of the U.S. equity markets. It is calculated and maintained by S&P Dow Jones Indices LLC. The S&P 500® Index is reported by Bloomberg L.P. under the ticker symbol "SPX."

"Standard & Poor's," "S&P" and "S&P 500®" are trademarks of Standard & Poor's Financial Services LLC and have been licensed for use by Citigroup Inc. and its affiliates. As of July 31, 2017, the securities of companies with multiple share class structures are no longer eligible to be added to the S&P 500® Index, but securities already included in the S&P 500® Index have been grandfathered and are not affected by this change. For more information, see "Equity Index Descriptions—The S&P U.S. Indices—License Agreement" in the accompanying underlying supplement.

Please refer to the section "Equity Index Descriptions—The S&P U.S. Indices—The S&P 500® Index" in the accompanying underlying supplement for important disclosures regarding the S&P 500® Index.

The graph below illustrates the performance of the S&P 500® Index from January 2, 2008 to May 18, 2018. The closing level of the S&P 500® Index on May 18, 2018 was 2,712.97. We obtained the closing levels of the S&P 500® Index from Bloomberg, and we have not participated in the preparation of or verified such information. The historical closing levels of the S&P 500® Index should not be taken as an indication of future performance and no assurance can be given as to the final underlying level or any future closing level of the S&P 500® Index. We cannot give you assurance that the performance of the S&P 500® Index will result in a positive return on your initial investment and you could lose a significant portion or all of the stated principal amount at maturity.

The EURO STOXX 50® Index

The EURO STOXX 50® Index is composed of 50 component stocks of market sector leaders from within the 19 EURO STOXX® Supersector Indices, which represent the Eurozone portion of the STOXX Europe 600® Supersector Indices. The STOXX Europe 600® Supersector Indices contain the 600 largest stocks traded on the major exchanges of 18 European countries. It is calculated and maintained by STOXX Limited. The EURO STOXX 50® Index is reported by Bloomberg L.P. under the ticker symbol "SX5E."

The "EURO STOXX 50® Index" is a trademark of STOXX Limited and has been licensed for use by Citigroup Inc. and its affiliates. For more information, see "Equity Index Descriptions—EURO STOXX 50® Index—License Agreement" in the accompanying underlying supplement.

Please refer to the section "Equity Index Descriptions—EURO STOXX 50® Index" in the accompanying underlying supplement for important disclosures regarding the EURO STOXX 50® Index.

The graph below illustrates the performance of the EURO STOXX 50® Index from January 2, 2008 to May 18, 2018. The closing level of the EURO STOXX 50® Index on May 18, 2018 was 3,573.76. We obtained the closing levels of the EURO STOXX 50® Index from Bloomberg, and we have not participated in the preparation of or verified such information. The historical closing levels of the EURO STOXX 50® Index should not be taken as an indication of future performance and no assurance can be given as to the final underlying level or any future closing level of the EURO STOXX 50® Index. We cannot give you assurance that the performance of the EURO STOXX 50® Index will result in a positive return on your initial investment and you could lose a significant portion or all of the stated principal amount at maturity.

Correlation of the Underlyings

The following graph sets forth the historical performances of the S&P 500® Index and the EURO STOXX 50® Index from January 2, 2008 through May 18, 2018, based on the daily closing levels of the underlyings. For comparison purposes, each underlying has been normalized to have a closing level of 100.00 on January 2, 2008 by dividing the closing level of that underlying on each day by the closing level of that underlying on January 2, 2008 and multiplying by 100.00.

We obtained the closing levels used to determine the normalized closing levels set forth below from Bloomberg, without independent verification. Historical performance of the underlyings should not be taken as an indication of future performance. Future performance of the underlyings may differ significantly from historical performance, and no assurance can be given as to the closing levels of the underlyings during the term of the notes, including on any valuation date. Moreover, any historical correlation between the underlyings is not indicative of the degree of correlation between the underlyings, if any, over the term of the notes.

PAST PERFORMANCE AND CORRELATION BETWEEN THE UNDERLYINGS IS NOT INDICATIVE OF FUTURE PERFORMANCE OR CORRELATION

Correlation is a measure of the extent to which two underlyings tend to increase or decrease at similar times and by similar magnitudes over a given time period. The closer the relationship of the returns of a pair of underlyings over a given period, the more correlated those underlyings are. Conversely, the less closely related the returns of a pair of underlyings, the less correlated those underlyings are. Two underlyings may also be inversely correlated, which means that they tend to move in opposite directions from one another. The graph above illustrates the historical performance of each underlying relative to the other over the time period shown and provides an indication of how close the performance of each underlying has historically been to the other underlying. However, the graph does not provide a precise measure of correlation and there may be relevant aspects of the historical correlation between the underlyings that cannot be discerned from the graph. Furthermore, regardless of the degree of correlation between the underlyings in the past, past correlation is not indicative of future correlation, and it is possible that the underlyings will exhibit significantly lower correlation in the future than they did in the past. We cannot predict the relationship between the underlyings over the term of the notes. For additional information, see "Summary Risk Factors—You will be subject to risks relating to the relationship between the underlyings."

The lower (or more negative) the correlation between the underlyings, the less likely it is that the underlyings will move in the same direction at the same time and, therefore, the greater the potential for one of the underlyings to close below its coupon barrier or downside threshold on any valuation date or the final valuation date, respectively. This is because the less correlated the underlyings are, the greater the likelihood that at least one of the underlyings will decrease in value. However, even if the underlyings have a higher correlation, one or both of the underlyings might close below its coupon barrier or downside threshold on any valuation date or the final valuation date, respectively, as both of the underlyings may decrease in value together.

The terms of the notes are set, in part, based on expectations about the correlation between the underlyings as of the trade date. If expectations about the correlation between the underlyings change over the term of the notes, the value of the notes may be adversely affected, and if the actual correlation between the underlyings proves to be lower than initially expected, the notes may prove to be riskier than expected on the trade date. The correlation referenced in setting the terms of the notes is calculated using CGMI's proprietary derivative-pricing model and is not derived from the returns of the underlyings over the period set forth in the graph above. In addition, factors and inputs other than correlation impact how the terms of the notes are set and the performance of the notes.

United States Federal Tax Considerations

You should read carefully the discussion under "United States Federal Tax Considerations" and "Risk Factors Relating to the Securities" in the accompanying product supplement and "Summary Risk Factors" in this pricing supplement.

Due to the lack of any controlling legal authority, there is substantial uncertainty regarding the U.S. federal tax consequences of an investment in the notes. In connection with any information reporting requirements we may have in respect of the notes under applicable law, we intend (in the absence of an administrative determination or judicial ruling to the contrary) to treat the notes for U.S. federal income tax purposes as prepaid forward contracts with associated coupon payments that will be treated as gross income to you at the time received or accrued in accordance with your regular method of tax accounting. In the opinion of our counsel, Davis Polk & Wardwell LLP, which is based on current market conditions, this treatment of the notes is reasonable under current law; however, our counsel has advised us that it is unable to conclude affirmatively that this treatment is more likely than not to be upheld, and that alternative treatments are possible.

Assuming this treatment of the notes is respected and subject to the discussion in "United States Federal Tax Considerations" in the accompanying product supplement, the following U.S. federal income tax consequences should result under current law:

- Any coupon payments on the notes should be taxable as ordinary income to you at the time received or accrued in accordance with your regular method of accounting for U.S. federal income tax purposes.

- Upon a sale or exchange of a note (including retirement at maturity), you should recognize capital gain or loss equal to the difference between the amount realized and your tax basis in the note. For this purpose, the amount realized does not include any coupon paid on retirement and may not include sale proceeds attributable to an accrued coupon, which may be treated as a coupon payment. Such gain or loss should be long-term capital gain or loss if you held the note for more than one year.

We do not plan to request a ruling from the IRS regarding the treatment of the notes, and the IRS or a court might not agree with the treatment described herein. In addition, the U.S. Treasury Department and the IRS have released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts." While it is not clear whether the notes would be viewed as similar to the typical prepaid forward contract described in the notice, it is possible that any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the notes, including the character and timing of income or loss, possibly with retroactive effect. You should consult your tax adviser regarding possible alternative tax treatments of the notes and potential consequences of the IRS notice.

Withholding Tax on Non-U.S. Holders. Because significant aspects of the tax treatment of the notes are uncertain, persons having withholding responsibility in respect of the notes may withhold on any coupon payment paid to Non-U.S. Holders (as defined in the accompanying product supplement), generally at a rate of 30%. To the extent that

we have (or an affiliate of ours has) withholding responsibility in respect of the notes, we intend to so withhold. In order to claim an exemption from, or a reduction in, the 30% withholding, you may need to comply with certification requirements to establish that you are not a U.S. person and are eligible for such an exemption or reduction under an applicable tax treaty. You should consult your tax adviser regarding the tax treatment of the notes, including the possibility of obtaining a refund of any amounts withheld and the certification requirement described above.

Moreover, as discussed under “United States Federal Tax Considerations – Tax Consequences to Non-U.S. Holders – Possible Withholding Under Section 871(m) of the Code” in the accompanying product supplement, Section 871(m) of the Code and Treasury regulations promulgated thereunder (“Section 871(m)”) generally impose a 30% withholding tax on dividend equivalents paid or deemed paid to Non-U.S. Holders with respect to certain financial instruments linked to U.S. equities (“U.S. Underlying Equities”) or indices that include U.S. Underlying Equities. Section 871(m) generally applies to instruments that substantially replicate the economic performance of one or more U.S. Underlying Equities, as determined based on tests set forth in the applicable Treasury regulations (a “Specified Security”). However, the regulations, as modified by an IRS notice, exempt financial instruments issued in 2018 that do not have a “delta” of one. Based on the terms of the notes and representations provided by us, our counsel is of the opinion that the notes should not be treated as transactions that have a “delta” of one within the meaning of the regulations with respect to any U.S. Underlying Equity and, therefore, should not be Specified Securities subject to withholding tax under Section 871(m).

A determination that the notes are not subject to Section 871(m) is not binding on the IRS, and the IRS may disagree with this treatment. Moreover, Section 871(m) is complex and its application may depend on your particular circumstances. For example, if you enter into other transactions relating to a U.S. Underlying Equity, you could be subject to withholding tax or income tax liability under Section 871(m) even if the notes are not Specified Securities subject to Section 871(m) as a general matter. You should consult your tax adviser regarding the potential application of Section 871(m) to the notes.

This information is indicative and will be updated in the final pricing supplement or may otherwise be updated by us in writing from time to time. Non-U.S. Holders should be warned that Section 871(m) may apply to the notes based on circumstances as of the pricing date for the notes and, therefore, it is possible that the notes will be subject to withholding tax under Section 871(m).

We will not be required to pay any additional amounts with respect to amounts withheld.

You should read the section entitled “United States Federal Tax Considerations” in the accompanying product supplement. The preceding discussion, when read in combination with that section, constitutes the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of owning and disposing of the notes.

You should also consult your tax adviser regarding all aspects of the U.S. federal income and estate tax consequences of an investment in the notes and any tax consequences arising under the laws of any state, local

or non-U.S. taxing jurisdiction.

Supplemental Plan of Distribution

CGMI, an affiliate of Citigroup Global Markets Holdings Inc. and the lead agent for the sale of the notes, will receive an underwriting discount of $0.35 for any note sold in this offering. UBS, as agent for sales of the notes, expects to purchase from CGMI, and CGMI expects to sell to UBS, all of the notes sold in this offering for $9.65 per note. UBS proposes to offer the notes to the public at a price of $9.65 per note. UBS will receive an underwriting discount of $0.35 for each note it sells to the public. The underwriting discount will be received by UBS and its financial advisors collectively If all of the notes are not sold at the initial offering price, CGMI may change the public offering price and other selling terms. For the avoidance of doubt, the underwriting discount will not be rebated if the notes are automatically called prior to maturity.

CGMI is an affiliate of ours. Accordingly, this offering will conform with the requirements addressing conflicts of interest when distributing the notes of an affiliate set forth in Rule 5121 of the Financial Industry Regulatory Authority. Client accounts over which Citigroup Inc. or its subsidiaries have investment discretion will not be permitted to purchase the notes, either directly or indirectly, without the prior written consent of the client.

See "Plan of Distribution; Conflicts of Interest" in the accompanying product supplement and "Plan of Distribution" in each of the accompanying prospectus supplement and prospectus for additional information.

A portion of the net proceeds from the sale of the notes will be used to hedge our obligations under the notes. We expect to hedge our obligations under the notes through CGMI or other of our affiliates. It is expected that CGMI or such other affiliates may profit from such expected hedging activity even if the value of the notes declines. This hedging activity could affect the closing levels of the underlyings and, therefore, the value of and your return on the notes. For additional information on the ways in which our counterparties may hedge our obligations under the notes, see "Use of Proceeds and Hedging" in the accompanying prospectus.

Certain Selling Restrictions

Prohibition of Sales to EEA Retail Investors

The notes may not be offered, sold or otherwise made available to any retail investor in the European Economic Area. For the purposes of this provision:

(a) the expression "retail investor" means a person who is one (or more) of the following:

(i) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, "MiFID II"); or

(ii) a customer within the meaning of Directive 2002/92/EC, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or

(iii) not a qualified investor as defined in Directive 2003/71/EC; and

(b) the expression "offer" includes the communication in any form and by any means of sufficient information on the terms of the offer and the notes offered so as to enable an investor to decide to purchase or subscribe the notes.

Valuation of the Notes

CGMI calculated the estimated value of the notes set forth on the cover page of this pricing supplement based on proprietary pricing models. CGMI's proprietary pricing models generated an estimated value for the notes by estimating the value of a hypothetical package of financial instruments that would replicate the payout on the notes, which consists of a fixed-income bond (the "**bond component**") and one or more derivative instruments underlying the economic terms of the notes (the "**derivative component**"). CGMI calculated the estimated value of the bond component using a discount rate based on our internal funding rate. CGMI calculated the estimated value of the derivative component based on a proprietary derivative-pricing model, which generated a theoretical price for the instruments that constitute the derivative component based on various inputs, including the factors described under "Summary Risk Factors—The value of the notes prior to maturity will fluctuate based on many unpredictable factors" in this pricing supplement, but not including our or Citigroup Inc.'s creditworthiness. These inputs may be market-observable or may be based on assumptions made by CGMI in its discretionary judgment.

The estimated value of the notes is a function of the terms of the notes and the inputs to CGMI's proprietary pricing models. As of the date of this preliminary pricing supplement, it is uncertain what the estimated value of the notes will be on the trade date because certain terms of the notes have not yet been fixed and because it is uncertain what the values of the inputs to CGMI's proprietary pricing models will be on the trade date.

During a temporary adjustment period immediately following issuance of the notes, the price, if any, at which CGMI would be willing to buy the notes from investors, and the value that will be indicated for the notes on any account statements prepared by CGMI or its affiliates (which value CGMI may also publish through one or more financial information vendors), will reflect a temporary upward adjustment from the price or value that would otherwise be determined. This temporary upward adjustment represents a portion of the hedging profit expected to be realized by CGMI or its affiliates over the term of the notes. The amount of this temporary upward adjustment will decline to zero over the temporary adjustment period. CGMI currently expects that the temporary adjustment period will be approximately 12 months, but the actual length of the temporary adjustment period may be shortened due to various factors, such as the volume of secondary market purchases of the notes and other factors that cannot be predicted. However, CGMI is not obligated to buy the notes from investors at any time. See "Summary Risk Factors—The notes will not be listed on a securities exchange and you may not be able to sell them prior to maturity."

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market developments that affect consumer confidence may cause adverse changes in payment patterns by our customers, causing increases in delinquencies and default rates on loans and other credit facilities;

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the processes that we use to estimate our allowance for loan and lease losses and reserves may no longer be reliable because they rely on judgments, such as forecasts of economic conditions, that may no longer be capable of accurate estimation;

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the value of our securities portfolio may decline; and

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we face increased regulation of our industry, and the costs of compliance with such regulation may increase.

These conditions or similar ones may continue to persist or worsen, causing us to experience continuing or increased adverse effects on our business, financial condition, results of operations and the price of our common stock.

Changes in economic conditions, in particular an economic slowdown in South Carolina, could materially and negatively affect our business.

Our business is directly impacted by factors such as economic, political and market conditions, broad trends in industry and finance, legislative and regulatory changes, changes in government monetary and fiscal policies and inflation, all of which are beyond our control. Any further deterioration in economic conditions, whether caused by national or local concerns, in particular any further economic slowdown in South Carolina, could result in the following consequences, any of which could hurt our business materially: loan delinquencies may increase; problem assets and foreclosures may increase; demand for our products and services may decrease; low cost or noninterest

bearing deposits may decrease; and collateral for loans made by us, especially real estate, may decline in value, in turn reducing customers borrowing power, and reducing the value of assets and collateral associated with our existing loans. The State of South Carolina and certain local governments in our market area continue to face fiscal challenges upon which the long-term impact on the State s or the local economy cannot be predicted.

Continuation of the economic downturn could reduce our customer base, our level of deposits, and demand for financial products such as loans.

Our success significantly depends upon the growth in population, income levels, deposits, and housing starts in our markets. The current economic downturn has negatively affected the markets in which we operate and, in turn, the quality of our loan portfolio. If the communities in which we operate do not grow or if prevailing economic conditions locally or nationally remain unfavorable, our business may not succeed. A continuation of the economic downturn or prolonged recession would likely result in the continued deterioration of the quality of our loan portfolio and reduce our level of deposits, which in turn would hurt our business. Interest received on loans represented approximately 94.8% of our interest income for the year ended December 31, 2013. If the economic downturn continues or a prolonged economic recession occurs in the economy as a whole, borrowers will be less likely to repay their loans as scheduled. Moreover, in many cases the value of real estate or other collateral that secures our loans has been adversely affected by the economic conditions and could continue to be negatively affected. Unlike many larger institutions, we are not able to spread the risks of unfavorable local economic conditions across a large number of diversified economies. A continued economic downturn could, therefore, result in losses that materially and adversely affect our business.

Higher FDIC deposit insurance premiums and assessments could adversely impact our financial condition.

Our deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC and are subject to deposit insurance assessments to maintain deposit insurance. As an FDIC-insured institution, we are required to pay quarterly deposit insurance premium assessments to the FDIC. Although we cannot predict what the insurance assessment rates will be in the future, either a deterioration in our risk-based capital ratios or adjustments to the base assessment rates could have a material adverse impact on our business, financial condition, results of operations, and cash flows.

Our small- to medium-sized business target markets may have fewer financial resources to weather a downturn in the economy.

We target the banking and financial services needs of small- and medium-sized businesses. These businesses generally have fewer financial resources in terms of capital borrowing capacity than larger entities. If general economic conditions continue to negatively impact these businesses in the markets in which we operate, our business, financial condition, and results of operation may be adversely affected.

We depend on the accuracy and completeness of information about clients and counterparties and our financial condition could be adversely affected if it relies on misleading information.

In deciding whether to extend credit or to enter into other transactions with clients and counterparties, we may rely on information furnished to us by or on behalf of clients and counterparties, including financial statements and other financial information, which we do not independently verify. We also may rely on representations of clients and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. For example, in deciding whether to extend credit to clients, we may assume that a customer s audited financial statements conform with U.S. Generally Accepted Accounting Principles (U.S. GAAP)

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and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. Our financial condition and results of operations could be negatively impacted to the extent we rely on financial statements that do not comply with GAAP or are materially misleading.

Changes in prevailing interest rates may reduce our profitability.

Our results of operations depend in large part upon the level of our net interest income, which is the difference between interest income from interest-earning assets, such as loans and investment securities, and interest expense on interest-bearing liabilities, such as deposits and other borrowings. Depending on the terms and maturities of our assets and liabilities, a significant change in interest rates could have a material adverse effect on our profitability. Many factors cause changes in interest rates, including governmental monetary policies and domestic and international economic and political conditions. While we intend to manage the effects of changes in interest rates by adjusting the terms, maturities, and pricing of our assets and liabilities, our efforts may not be effective and our financial condition and results of operations could suffer.

We may not be able to adequately anticipate and respond to changes in market interest rates.

We may be unable to anticipate changes in market interest rates, which are affected by many factors beyond our control including but not limited to inflation, recession, unemployment, money supply, monetary policy, and other changes that affect financial markets both domestic and foreign. Our net interest income is affected not only by the level and direction of interest rates, but also by the shape of the yield curve and relationships between interest

sensitive instruments and key driver rates, as well as balance sheet growth, customer loan and deposit preferences, and the timing of changes in these variables. In the event rates increase, our interest costs on liabilities may increase more rapidly than our income on interest earning assets, resulting in a deterioration of net interest margins. As such, fluctuations in interest rates could have significant adverse effects on our financial condition and results of operations.

In addition, our mortgage operations provide a portion of our noninterest income. We generate mortgage revenues primarily from gains on the sale of residential mortgage loans pursuant to programs currently offered by Fannie Mae, Ginnie Mae or Freddie Mac. In a rising or higher interest rate environment, our originations of mortgage loans may decrease, resulting in fewer loans that are available to be sold to investors, which would decrease mortgage revenues in noninterest income. In addition, our results of operations are affected by the amount of noninterest expenses associated with mortgage activities, such as salaries and employee benefits, other loan expense, and other costs. During periods of reduced loan demand, our results of operations may be adversely affected to the extent that we are unable to reduce expenses commensurate with the decline in loan originations.

We are dependent on key individuals and the loss of one or more of these key individuals could curtail our growth and adversely affect our prospects.

R. Arthur Seaver, Jr., our chief executive officer, and F. Justin Strickland, our president, each has extensive and long-standing ties within our primary market area and substantial experience with our operations, and each has contributed significantly to our growth. If we lose the services of Mr. Seaver or Mr. Strickland, either would be difficult to replace and our business and development could be materially and adversely affected.

Our success also depends, in part, on our continued ability to attract and retain experienced loan originators, as well as other management personnel, including Justin Strickland, Fred Gilmer, III, and Lenwood Howell. Competition for personnel is intense, and we may not be successful in attracting or retaining qualified personnel. Our failure to compete for these personnel, or the loss of the services of several of such key personnel, could adversely affect our growth strategy and seriously harm our business, results of operations, and financial condition.

We may be adversely affected by the soundness of other financial institutions.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by the Bank cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to the Bank. Any such losses could have a material adverse effect on our financial condition and results of operations.

Competition with other financial institutions may have an adverse effect on our ability to retain and grow our client base, which could have a negative effect on our financial condition or results of operations.

The banking and financial services industry is very competitive and includes services offered from other banks, savings and loan associations, credit unions, mortgage companies, other lenders, and institutions offering uninsured investment alternatives. Legal and regulatory developments have made it easier for new and sometimes unregulated competitors to compete with us. The financial services industry has and is experiencing an ongoing trend towards consolidation in which fewer large national and regional banks and other financial institutions are replacing many smaller and more local banks. These larger banks and other financial institutions hold a large accumulation of assets and have significantly greater resources and a wider geographic presence or greater accessibility. In some instances, these larger entities operate without the traditional brick and mortar facilities that restrict geographic presence. Some competitors have more aggressive marketing campaigns and better brand recognition, and are able to offer more services, more favorable pricing or greater customer convenience than our Bank. In addition, competition has increased from new banks and other financial services providers that target our existing or potential customers. As consolidation continues among large banks, we expect other smaller institutions to try to compete in the markets we serve. This competition could reduce our net income by decreasing the number and size of the loans that we originate and the interest rates we charge on these loans. Additionally, these competitors may offer higher interest rates, which could decrease the deposits we attract or require us to increase rates to retain existing deposits or attract new deposits. Increased deposit competition could adversely affect our ability to generate the funds necessary for lending operations which could increase our cost of funds.

The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge as part of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Technological developments have allowed competitors, including some non-depository institutions, to compete more effectively in local markets and have expanded the range of financial products, services and capital available to our target customers. If we are unable to implement, maintain and use such technologies effectively, we may not be able to offer products or achieve cost-efficiencies necessary to compete in the industry. In addition, some of these competitors have fewer regulatory constraints and lower cost structures.

Liquidity needs could adversely affect our financial condition and results of operation.

Dividends from our Bank provide one source of funds for our Company. The primary sources of funds of our Bank are customer deposits and loan repayments. While scheduled loan repayments are a relatively stable source of funds, they are subject to the ability of borrowers to repay the loans. The ability of borrowers to repay loans can be adversely affected by a number of factors, including changes in economic conditions, adverse trends or events affecting business industry groups, reductions in real estate values or markets, business closings or lay-offs, inclement weather, which could be exacerbated by potential climate change, natural disasters and international instability.

Additionally, deposit levels may be affected by a number of factors, including rates paid by competitors, general interest rate levels, regulatory capital requirements, returns available to customers on alternative investments and general economic conditions. Accordingly, we may be required from time to time to rely on secondary sources of liquidity to meet withdrawal demands or otherwise fund operations. Such sources include proceeds from Federal Home Loan Bank advances, sales of investment securities and loans, and federal funds lines of credit from correspondent banks, as well as out-of-market time deposits. While we believe that these sources are currently adequate, there can be no assurance they will be sufficient to meet future liquidity demands, particularly if we continue to grow and experience increasing loan demand. We may be required to slow or discontinue loan growth, capital expenditures or other investments or liquidate assets should such sources not be adequate.

We may need to raise additional capital in the future to redeem the Series T Preferred Stock or to support further growth, but that capital may not be available when it is needed.

We are required by regulatory authorities to maintain adequate levels of capital to support our operations. To support our continued growth, we may need to raise additional capital. In addition, we intend to redeem remaining outstanding shares of our Series T Preferred Stock that we originally issued to the Treasury under the CPP, and we may need to raise additional capital to do so. Our ability to raise additional capital, if needed, will depend in part on conditions in the capital markets at that time, which are outside our control. Accordingly, we cannot assure you of our ability to raise additional capital, if needed, on terms acceptable to us. If we cannot raise additional capital when needed, our ability to

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further expand our operations through internal growth and acquisitions could be materially impaired. In addition, if we decide to raise additional equity capital, your interest could be diluted.

We will face risks with respect to future expansion and acquisitions or mergers.

We may seek to acquire other financial institutions or parts of those institutions. We may also expand into new markets, as we did in Columbia, South Carolina in 2007 and Charleston in 2012. We may also expand our lines of business or offer new products or services. These activities would involve a number of risks, including:

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the potential inaccuracy of the estimates and judgments used to evaluate credit, operations, management, and market risks with respect to a target institution;

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the time and costs of evaluating new markets, hiring or retaining experienced local management, and opening new offices and the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion;

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the incurrence and possible impairment of goodwill associated with an acquisition and possible adverse effects on our results of operations; and

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the risk of loss of key employees and customers.

The success of our growth strategy depends on our ability to identify and retain individuals with experience and relationships in the markets in which we intend to expand.

To expand our franchise successfully, we must identify and retain experienced key management members with local expertise and relationships in these markets. We expect that competition for qualified management in the markets in which we may expand will be intense and that there will be a limited number of qualified persons with knowledge of and experience in the community banking industry in these markets. Even if we identify individuals that we believe could assist us in establishing a presence in a new market, we may be unable to recruit these individuals away from more established financial institutions. In addition, the process of identifying and recruiting individuals with the combination of skills and attributes required to carry out our strategy requires both management and financial resources and is often lengthy. Our inability to identify, recruit, and retain talented personnel to manage new offices effectively would limit our growth and could materially adversely affect our business, financial condition, and results of operations.

A percentage of the loans in our portfolio currently include exceptions to our loan policies and supervisory guidelines.

All of the loans that we make are subject to written loan policies adopted by our board of directors and to supervisory guidelines imposed by our regulators. Our loan policies are designed to reduce the risks associated with the loans that we make by requiring our loan officers to take certain steps that vary depending on the type and amount of the loan, prior to closing a loan. These steps include, among other things, making sure the proper liens are documented and perfected on property securing a loan, and requiring proof of adequate insurance coverage on property securing loans. Loans that do not fully comply with our loan policies are known as exceptions. We categorize exceptions as policy exceptions, financial statement exceptions and document exceptions. As a result of these exceptions, such loans may have a higher risk of loan loss than the other loans in our portfolio that fully comply with our loan policies. In addition, we may be subject to regulatory action by federal or state banking authorities if they believe the number of exceptions in our loan portfolio represents an unsafe banking practice.

Our operational or security systems may experience and interruption or breach in security.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, deposit, loan, and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

Our controls and procedures may fail or be circumvented.

We regularly review and update our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

Negative public opinion surrounding our Company and the financial institutions industry generally could damage our reputation and adversely impact our earnings.

Reputation risk, or the risk to our business, earnings and capital from negative public opinion surrounding our Company and the financial institutions industry generally, is inherent in our business. Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to keep and attract clients and employees and can expose us to litigation and regulatory action. Although we take steps to minimize reputation risk in dealing with our clients and communities, this risk will always be present given the nature of our business.

Regulatory and Legal Risks

We are subject to extensive regulation that could restrict our activities, have an adverse impact on our operations, and impose financial requirements or limitations on the conduct of our business.

We operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by various regulatory agencies. We are subject to Federal Reserve regulation. Our Bank is subject to extensive regulation, supervision, and examination by our primary federal regulator, the FDIC, the regulating authority that insures customer deposits. Also, as a member of the FHLB, our Bank must comply with applicable regulations of the Federal Housing Finance Board and the FHLB. Regulation by these agencies is intended primarily for the protection of our depositors and the deposit insurance fund and not for the benefit of our shareholders. Our Bank s activities are also regulated under consumer protection laws applicable to our lending, deposit, and other activities. A sufficient claim against us under these laws could have a material adverse effect on our results of operations.

Further, changes in laws, regulations and regulatory practices affecting the financial services industry could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could also result in heightened regulatory scrutiny and in sanctions by regulatory agencies (such as a memorandum of understanding, a written supervisory agreement or a cease and desist order), civil money penalties and/or reputation damage. Any of these consequences could restrict our ability to expand our business or could require us to raise additional capital or sell assets on terms that are not advantageous to us or our shareholders and could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations, such violations may occur despite our best efforts.

The Dodd-Frank Act may have a material adverse effect on our operations.

On July 21, 2010, President Obama signed into law the Dodd-Frank Act, which imposes significant regulatory and compliance changes. The key effects of the Dodd-Frank Act on our business are:

- changes to regulatory capital requirements;
- exclusion of hybrid securities, including trust preferred securities, issued on or after May 19, 2010 from Tier 1 capital;
- creation of new government regulatory agencies (such as the Financial Stability Oversight Council, which oversees systemic risk, and the CFPB, which develops and enforces rules for bank and non-bank providers of consumer financial products);
- potential limitations on federal preemption;
- changes to deposit insurance assessments;
- regulation of debit interchange fees we earn;
- changes in retail banking regulations, including potential limitations on certain fees we may charge; and
- changes in regulation of consumer mortgage loan origination and risk retention.

In addition, the Dodd-Frank Act restricts the ability of banks to engage in certain proprietary trading or to sponsor or invest in private equity or hedge funds. The Dodd-Frank Act also contains provisions designed to limit the ability of insured depository institutions, their holding companies and their affiliates to conduct certain swaps and derivatives activities and to take certain principal positions in financial instruments.

Some provisions of the Dodd-Frank Act became effective immediately upon its enactment. Many provisions, however, will require regulations to be promulgated by various federal agencies in order to be implemented, some but not all of which have been proposed or finalized by the applicable federal agencies. The provisions of the Dodd-Frank Act may have unintended effects, which will not be clear until after implementation. Certain changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to investors in our common stock.

New capital rules that were recently issued generally require insured depository institutions and their holding companies to hold more capital. The impact of the new rules on our financial condition and operations is uncertain but could be materially adverse.

On July 2, 2013, the Federal Reserve adopted a final rule for the Basel III capital framework and, on July 9, 2013, the OCC also adopted a final rule and the FDIC adopted the same provisions in the form of an "interim final rule." These rules substantially amend the regulatory risk-based capital rules applicable to us. The rules phase in over time beginning in 2015 and will become fully effective in 2019. The rules apply to the Company as well as to the Bank.

The final rules increase capital requirements and generally include two new capital measurements that will affect us, a risk-based common equity Tier 1 ratio and a capital conservation buffer. Common Equity Tier 1 (CET1) capital is a subset of Tier 1 capital and is limited to common equity (plus related surplus), retained earnings, accumulated other comprehensive income and certain other items. Other instruments that have historically qualified for Tier 1 treatment, including non-cumulative perpetual preferred stock, are consigned to a category known as Additional Tier 1 capital and must be phased out over a period of nine years beginning in 2014. The rules permit bank holding companies with less than $15 billion in assets (such as us) to continue to include trust preferred securities and non-cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not CET1. Tier 2 capital consists of instruments that have historically been placed in Tier 2, as well as cumulative perpetual preferred stock.

The final rules adjust all three categories of capital by requiring new deductions from and adjustments to capital that will result in more stringent capital requirements and may require changes in the ways we do business. Among other things, the current rule on the deduction of mortgage servicing assets from Tier 1 capital has been revised in ways that

are likely to require a greater deduction than we currently make and that will require the deduction to be made from CET1. This deduction phases in over a three-year period from 2015 through 2017. We closely monitor our mortgage servicing assets, and we expect to maintain our mortgage servicing asset at levels below the deduction thresholds by a combination of sales of portions of these assets from time to time either on a flowing basis as we originate mortgages or through bulk sale transactions. Additionally, any gains on sale from mortgage loans sold into securitizations must be deducted in full from CET1. This requirement phases in over three years from 2015 through 2017. Under the earlier rule and through 2014, no deduction is required.

Beginning in 2015, the minimum capital requirements for the Company and the Bank will be (i) a CET1 ratio of 4.5%, (ii) a Tier 1 capital (CET1 plus Additional Tier 1 capital) of 6% (up from 4%) and (iii) a total capital ratio of 8% (the current requirement). Our leverage ratio requirement will remain at the 4% level now required. Beginning in 2016, a capital conservation buffer will phase in over three years, ultimately resulting in a requirement of 2.5% on top of the CET1, Tier 1 and total capital requirements, resulting in a require CET1 ratio of 7%, a Tier 1 ratio of 8.5%, and a total capital ratio of 10.5%. Failure to satisfy any of these three capital requirements will result in limits on paying dividends, engaging in share repurchases and paying discretionary bonuses. These limitations will establish a maximum percentage of eligible retained income that could be utilized for such actions. While the final rules will result in higher regulatory capital standards, it is difficult at this time to predict when or how any new standards will ultimately be applied to us.

In addition to the higher required capital ratios and the new deductions and adjustments, the final rules increase the risk weights for certain assets, meaning that we will have to hold more capital against these assets. For example, commercial real estate loans that do not meet certain new underwriting requirements must be risk-weighted at 150%,

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rather than the current 100%. There are also new risk weights for unsettled transactions and derivatives. We also will be required to hold capital against short-term commitments that are not unconditionally cancelable; currently, there are no capital requirements for these off-balance sheet assets. All changes to the risk weights take effect in full in 2015.

In addition, in the current economic and regulatory environment, bank regulators may impose capital requirements that are more stringent than those required by applicable existing regulations. The application of more stringent capital requirements for us could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital or additional capital conservation buffers, could result in management modifying our business strategy and could limit our ability to make distributions, including paying dividends or buying back our shares.

The federal banking agencies are likely to issue new liquidity standards that could result in our having to lengthen the term of our funding, restructure our business lines by forcing us to seek new sources of liquidity for them, and/or increase our holdings of liquid assets.

As part of the Basel III capital process, the Basel Committee on Banking Supervision has finalized a new liquidity standard, a liquidity coverage ratio, which requires a banking organization to hold sufficient "high quality liquid assets" to meet liquidity needs for a 30 calendar day liquidity stress scenario. A net stable funding ratio, which imposes a similar requirement over a one-year period, is under consideration. The U.S. banking regulators have said that they intend to adopt such liquidity standards, although they have not yet proposed a rule. New rules could restrict our operations by compelling us to reduce our holdings of illiquid assets and adversely affect our results and financial condition.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The federal Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (which we refer to as the Patriot Act) and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the OFAC. Federal and state bank regulators also have begun to focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we have already acquired or may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans, which would negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

Federal, state and local consumer lending laws may restrict our ability to originate certain mortgage loans or increase our risk of liability with respect to such loans and could increase our cost of doing business.

Federal, state and local laws have been adopted that are intended to eliminate certain lending practices considered predatory. These laws prohibit practices such as steering borrowers away from more affordable products, selling unnecessary insurance to borrowers, repeatedly refinancing loans and making loans without a reasonable expectation that the borrowers will be able to repay the loans irrespective of the value of the underlying property. Over the course

of 2013, the CFPB has issued several rules on mortgage lending, notably a rule requiring all home mortgage lenders to determine a borrower's ability to repay the loan. Loans with certain terms and conditions and that otherwise meet the definition of a qualified mortgage may be protected from liability to a borrower for failing to make the necessary determinations. In either case, we may find it necessary to tighten our mortgage loan underwriting standards in response to the CFPB rules, which may constrain our ability to make loans consistent with our business strategies. It is our policy not to make predatory loans and to determine borrowers' ability to repay, but the law and related rules create the potential for increased liability with respect to our lending and loan investment activities. They increase our cost of doing business and, ultimately, may prevent us from making certain loans and cause us to reduce the average percentage rate or the points and fees on loans that we do make.

We are subject to federal and state fair lending laws, and failure to comply with these laws could lead to material penalties.

Federal and state fair lending laws and regulations, such as the Equal Credit Opportunity Act and the Fair Housing Act, impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, CFPB and other federal and state agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. A successful challenge to our performance under the fair lending laws and regulations could adversely impact our rating under the CRA and result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on merger and acquisition activity and restrictions on expansion activity, which could negatively impact our reputation, business, financial condition and results of operations.

The Federal Reserve may require us to commit capital resources to support the Bank.

The Federal Reserve requires a bank holding company to act as a source of financial and managerial strength to a subsidiary bank and to commit resources to support such subsidiary bank. Under the source of strength doctrine, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to such a subsidiary bank. In addition, the Dodd-Frank Act directs the federal bank regulators to require that all companies that directly or indirectly control an insured depository institution serve as a source of strength for the institution. Under these requirements, in the future, we could be required to provide financial assistance to our Bank if the Bank experiences financial distress.

A capital injection may be required at times when we do not have the resources to provide it, and therefore we may be required to borrow the funds. In the event of a bank holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the holding company's general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be done by the holding company in order to make the required capital injection becomes more difficult and expensive and will adversely impact the holding company's cash flows, financial condition, results of operations and prospects.

The downgrade of the U.S. credit rating could negatively impact our business, results of operations and financial condition.

Recent U.S. debt ceiling and budget deficit concerns together with signs of deteriorating sovereign debt conditions in Europe, have increased the possibility of additional credit-rating downgrades and economic slowdowns in the U.S. Although U.S. lawmakers passed legislation to raise the federal debt ceiling in 2011, Standard & Poor's Ratings Services lowered its long-term sovereign credit rating on the U.S. from "AAA" to "AA+" in August 2011. The impact of any further downgrades to the U.S. government's sovereign credit rating or its perceived creditworthiness could adversely affect the U.S. and global financial markets and economic conditions. In January 2013, the U.S. government adopted legislation to suspend the debt limit until May 19, 2013. In October 2013, the debt ceiling was suspended until February 7, 2014. Moody's and Fitch have each warned that they may downgrade the U.S. government's rating if the federal debt is not stabilized. A downgrade of the U.S. government's credit rating or a default by the U.S. government to satisfy its debt obligations likely would create broader financial turmoil and uncertainty, which would weigh heavily on the global banking system. It is possible that any such impact could have a material adverse effect on our business, results of operations and financial condition.

Failure to comply with government regulation and supervision could result in sanctions by regulatory agencies, civil money penalties, and damage to our reputation.

Our operations are subject to extensive regulation by federal, state, and local governmental authorities. Given the current disruption in the financial markets, we expect that the government will continue to pass new regulations and laws that will impact us. Compliance with such regulations may increase our costs and limit our ability to pursue business opportunities. Failure to comply with laws, regulations, and policies could result in sanctions by regulatory agencies, civil money penalties, and damage to our reputation. While we have policies and procedures in place that are designed to prevent violations of these laws, regulations, and policies, there can be no assurance that such violations will not occur.

We are party to various lawsuits incidental to our business. Litigation is subject to many uncertainties such that the expenses and ultimate exposure with respect to many of these matters cannot be ascertained.

From time to time, customers and others make claims and take legal action pertaining to our performance of fiduciary responsibilities. Whether customer claims and legal action are legitimate or unfounded, if such claims and legal actions are not resolved in our favor they may result in significant financial liability and/or adversely affect the market perception of us and our products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Risks Related to Our Common Stock

Our ability to pay cash dividends is limited, and we may be unable to pay future dividends even if we desire to do so.

The Federal Reserve has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve s policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization s capital needs, asset quality and overall financial condition. The Federal Reserve s policies also require that a bank holding company serve as a source of financial strength to its subsidiary banks by standing ready to use available resources to provide adequate capital funds to those banks during periods of financial stress or adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks where necessary. In addition, the Company cannot pay cash dividends on its common stock during any calendar quarter unless full dividends on the Series T Preferred Stock for the dividend period ending during the calendar quarter have been declared and the Company has not failed to pay a dividend in the full amount of the Series T Preferred Stock with respect to the period in which such dividend payment in respect of its common stock would occur. Further, under the prompt corrective action regulations, the ability of a bank holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of the Company to pay dividends or otherwise engage in capital distributions.

If our Bank is not permitted to pay cash dividends to the Company, it is unlikely that we would be able to pay cash dividends on our common stock. Moreover, holders of our common stock are entitled to receive dividends only when, and if declared by our board of directors. Although we have historically paid cash dividends on our common stock, we are not required to do so and our board of directors could reduce or eliminate our common stock dividend in the future.

Our stock price may be volatile, which could result in losses to our investors and litigation against us.

Our stock price has been volatile in the past and several factors could cause the price to fluctuate substantially in the future. These factors include but are not limited to: actual or anticipated variations in earnings, changes in analysts recommendations or projections, our announcement of developments related to our businesses, operations and stock performance of other companies deemed to be peers, new technology used or services offered by traditional and non-traditional competitors, news reports of trends, irrational exuberance on the part of investors, new federal banking regulations, and other issues related to the financial services industry. Our stock price may fluctuate significantly in the future, and these fluctuations may be unrelated to our performance. General market declines or market volatility in the future, especially in the financial institutions sector, could adversely affect the price of our common stock, and the current market price may not be indicative of future market prices. Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. Moreover, in the past, securities class action lawsuits have been instituted against some companies following periods of volatility in the market price of its securities. We could in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management s attention and resources from our normal business.

Future sales of our stock by our shareholders or the perception that those sales could occur may cause our stock price to decline.

Although our common stock is listed for trading on The NASDAQ Global Market, the trading volume in our common stock is lower than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the relatively low trading volume of our common stock, significant sales of our common stock in the public market, or the perception that those sales may

occur, could cause the trading price of our common stock to decline or to be lower than it otherwise might be in the absence of those sales or perceptions.

Economic and other circumstances may require us to raise capital at times or in amounts that are unfavorable to us. If we have to issue shares of common stock, they will dilute the percentage ownership interest of existing

shareholders and may dilute the book value per share of our common stock and adversely affect the terms on which we may obtain additional capital.

We may need to incur additional debt or equity financing in the future to make strategic acquisitions or investments or to strengthen our capital position. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of our control and our financial performance. We cannot provide assurance that such financing will be available to us on acceptable terms or at all, or if we do raise additional capital that it will not be dilutive to existing shareholders.

If we determine, for any reason, that we need to raise capital, subject to applicable NASDAQ rules, our board generally has the authority, without action by or vote of the shareholders, to issue all or part of any authorized but unissued shares of stock for any corporate purpose, including issuance of equity-based incentives under or outside of our equity compensation plans. Additionally, we are not restricted from issuing additional common stock or preferred stock, including any securities that are convertible into or exchangeable for, or that represent the right to receive, common stock or preferred stock or any substantially similar securities. The market price of our common stock could decline as a result of sales by us of a large number of shares of common stock or preferred stock or similar securities in the market or from the perception that such sales could occur. If we issue preferred stock that has a preference over the common stock with respect to the payment of dividends or upon liquidation, dissolution or winding-up, or if we issue preferred stock with voting rights that dilute the voting power of the common stock, the rights of holders of the common stock or the market price of our common stock could be adversely affected. Any issuance of additional shares of stock will dilute the percentage ownership interest of our shareholders and may dilute the book value per share of our common stock. Shares we issue in connection with any such offering will increase the total number of shares and may dilute the economic and voting ownership interest of our existing shareholders.

The Series T Preferred Stock impacts net income available to our common shareholders and earnings per common share.

If we do not redeem all 15,299 shares of outstanding Series T Preferred Stock prior to May 15, 2014, the cost of any remaining Series T Preferred shares will increase from 5.0% per annum to 9.0% per annum. Dividends declared on the Series T Preferred Stock will reduce the net income available to common shareholders and our earnings per common share. The Series T Preferred Stock will also receive preferential treatment in the event of liquidation, dissolution or winding up of the Company.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our main office and headquarters are located on Verdae Boulevard near downtown Greenville, South Carolina. The building is a full service banking facility with three drive-through banking stations and an automatic teller machine. The lease for this location expires in April 2015.

Our Parkway office is located in the Thornblade area of Greenville, South Carolina, near the intersection of I-85 and Pelham Road. We own these premises.

Our Augusta Road office is located Greenville, South Carolina. We lease the land for this office and own the banking office. The lease for this location expires in April 2025.

Our Woodruff Road office is located in Greenville, South Carolina. We own these premises.

Our Lexington office is located on Sunset Boulevard in Lexington, South Carolina. We have a land lease on this property and own the banking office. The lease for this location expires in January 2028.

Our Columbia regional headquarters is located in Cayce, South Carolina. We own these premises.

Our Forest Drive office is located in Columbia, South Carolina. We own these premises.

Our Charleston office is located on East Bay Street in Charleston, South Carolina. The lease for this location expires in September 2016.

We purchased property in Mount Pleasant, South Carolina in April 2013 and are in the process of constructing a new

retail office on the site. The office is expected to open during the second half of 2014.

We believe these premises will be adequate for present and anticipated needs and that we have adequate insurance to cover our owned and leased premises. For each property that we lease, we believe that upon expiration of the lease we will be able to extend the lease on satisfactory terms or relocate to another acceptable location.

Item 3. Legal Proceedings.

In the ordinary course of operations, we may be a party to various legal proceedings from time to time. We do not believe that there is any pending or threatened proceeding against us, which, if determined adversely, would have a material effect on our business, results of operations, or financial condition.

Item 4. Mine Safety Disclosures.

None.

PART II

Item 5. Market for Common Equity and Related Shareholder Matters.

Our common stock is currently traded on the NASDAQ Global Market under the symbol SFST. We had approximately 1,100 shareholders of record on February 28, 2014.

The following table shows the reported high and low common stock prices reported by the NASDAQ Global Market for 2013 and 2012 (adjusted for the 10% stock dividends in 2013 and 2012).

2013	**High**	**Low**
First Quarter	$11.26	$8.41
Second Quarter	11.35	10.28

Third Quarter	13.63	10.80
Fourth Quarter	13.98	12.81
2012		
First Quarter	$6.69	$5.54
Second Quarter	8.18	6.24
Third Quarter	8.65	7.32
Fourth Quarter	9.00	7.96

We have not declared or paid any cash dividends on our common stock since our inception. For the foreseeable future, we do not intend to declare cash dividends. We intend to retain earnings to grow our business and strengthen our capital base. Our ability to pay cash dividends depends primarily on the ability of our subsidiary, Southern First Bank to pay dividends to us. As a South Carolina chartered bank, the Bank is subject to limitations on the amount of dividends that it is permitted to pay. Unless otherwise instructed by the S.C. Board, the Bank is generally permitted under South Carolina state banking regulations to pay cash dividends of up to 100% of net income in any calendar year without obtaining the prior approval of the S.C. Board. The FDIC also has the authority under federal law to enjoin a bank from engaging in what in its opinion constitutes an unsafe or unsound practice in conducting its business, including the payment of a dividend under certain circumstances.

The following table sets forth equity compensation plan information at December 31, 2013. The number of shares and the exercise prices for options and warrants has been adjusted for the 3 for 2 stock split in 2003 and the subsequent 10% stock dividends in 2006, 2011, 2012, and 2013.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (c) (excluding securities reflected in column(a))
Equity compensation plans approved by security			

holders			
2000 Stock options (1)	391,681	$6.84	-
2010 Stock Incentive Plan options	225,500	7.41	140,525
2006 Restricted Stock Plan	-	-	-
2010 Stock Incentive Plan restricted stock	-	-	18,549
Total	617,181	$7.05	159,074

(1) Under the terms of Plan no further incentive stock option awards may be granted, effective March 2010; however, the Plan will remain in effect until all awards have been exercised or forfeited and we determine to terminate the Plan. As of March 2010, any options that expire or are forfeited are eligible to be reissued as non-qualified stock option awards.

Item 6. Selected Financial Data

	Years Ended December 31,				
(dollars in thousands, except per share data)	**2013**	**2012**	**2011**	**2010**	**2009**
BALANCE SHEET DATA					
Total assets	$890,831	797,998	767,745	736,490	719,297
Investment securities	73,556	86,016	108,584	72,853	94,633
Loans, net (1)	727,054	636,858	589,709	564,006	566,510
Allowance for loan losses	10,213	9,091	8,925	8,386	7,760
Deposits	680,319	576,299	562,912	536,296	494,084
FHLB advances and related debt	124,100	124,100	122,700	122,700	146,950
Junior subordinated debentures	13,403	13,403	13,403	13,403	13,403
Shareholders equity	65,665	64,125	62,539	59,216	59,841
SELECTED RESULTS OF OPERATIONS DATA					
Interest income	$36,118	34,698	35,142	35,529	36,177
Interest expense	7,097	8,702	11,854	15,317	16,895
Net interest income	29,021	25,996	23,288	20,212	19,282
Provision for loan losses	3,475	4,550	5,270	5,610	4,310

Net interest income after provision for loan losses	25,546	21,446	18,018	14,602	14,972
Noninterest income (loss)	3,802	3,762	2,770	3,045	2,185
Noninterest expenses	21,812	19,513	17,867	16,564	15,393
Income before income tax expense	7,536	5,695	2,921	1,083	1,764
Income tax expense	2,416	1,833	833	193	345
Net income	5,120	3,862	2,088	890	1,419
Preferred stock dividends	771	840	865	865	730
Discount accretion (4)	-	360	279	260	200
Redemption of preferred stock	(20)	(96)	-	-	-
Net income (loss) available to common shareholders (4)	$4,369	2,758	944	(235)	489
PER COMMON SHARE DATA (2)(4)					
Basic	$1.02	$0.65	0.22	(0.06)	0.06
Diluted	0.98	0.64	0.22	(0.06)	0.06
Book value	11.66	11.26	10.93	10.25	10.63
Weighted average number of common shares outstanding:					
Basic, in thousands	4,280	4,230	4,201	4,179	4,066
Diluted, in thousands	4,459	4,340	4,287	4,179	4,101
SELECTED FINANCIAL RATIOS					
Performance Ratios:					
Return on average assets	0.61%	0.50%	0.28%	0.12%	0.20%
Return on average equity	7.88%	6.03%	3.40%	1.47%	2.51%
Return on average common equity (4)	8.81%	5.79%	2.10%	(0.53)%	1.20%
Net interest margin, tax equivalent	3.71%	3.61%	3.30%	2.91%	2.84%
Loan to deposit ratio (1)	108.37%	112.09%	106.35%	106.73%	116.23%
Efficiency ratio (3)	65.91%	63.19%	64.95%	70.46%	70.24%
Asset Quality Ratios:					
Nonperforming assets to total loans (1)	1.29%	1.53%	2.33%	2.61%	2.69%
Nonperforming assets to total assets (1)	1.07%	1.24%	1.82%	2.03%	2.15%
Net charge-offs to average total loans (1)	0.34%	0.71%	0.81%	0.86%	0.63%
Allowance for loan losses to nonperforming loans	122.50%	111.32%	86.96%	89.92%	66.09%
Allowance for loan losses to total loans (1)	1.39%	1.41%	1.49%	1.47%	1.35%
Capital Ratios:					
Average equity to average assets	7.74%	8.30%	8.12%	8.16%	7.85%
Common equity to assets (4)	5.65%	5.99%	5.98%	5.82%	6.09%
Bank Leverage ratio	9.10%	9.60%	9.50%	9.60%	9.60%
Bank Tier 1 risk-based capital ratio	10.90%	11.80%	11.90%	12.00%	11.60%
Bank Total risk-based capital ratio	12.20%	13.00%	13.10%	13.20%	12.80%

(1) Includes nonperforming loans.

(2) Adjusted for all years presented giving retroactive effect to 10% stock dividends in 2011, 2012, and 2013.

(3) Computed by dividing noninterest expense by the sum of net interest income on a tax equivalent basis and noninterest income, net of securities gains, losses, or impairment, and real estate activity.

(4) Amounts and ratios for 2009 and 2010 periods have been restated for a correction of an error which was not material to the interim or annual financial statements.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation

The following discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the accompanying financial statements. We encourage you to read this discussion and analysis in conjunction with the financial statements and the related notes and the other statistical information also included in this report.

OVERVIEW

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

At December 31, 2013, we had total assets of $890.8 million, an 11.6% increase from total assets of $798.0 million at December 31, 2012. The largest components of our total assets are loans and securities which were $737.3 million and $73.6 million, respectively, at December 31, 2013. Comparatively, our loans and securities totaled $646.0 million and $86.0 million, respectively, at December 31, 2012. Our liabilities and shareholders equity at December 31, 2013 totaled $825.2 million and $65.7 million, respectively, compared to liabilities of $733.9 million and shareholders equity of $64.1 million at December 31, 2012. The principal component of our liabilities is deposits which were $680.3 million and $576.3 million at December 31, 2013 and 2012, respectively.

Like most community banks, we derive the majority of our income from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay

interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowings. Another key measure is the difference between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread. In addition to earning interest on our loans and investments, we earn income through fees and other charges to our clients.

Our net income for the year ended December 31, 2013 was $5.1 million, a 32.6% increase from $3.9 million for the year ended December 31, 2012. After our dividend payment to our preferred stockholders, net income to common shareholders was $4.4 million, or diluted earnings per share (EPS) of $0.98, for the year ended December 31, 2013 as compared to a net income to common shareholders of $2.8 million, or diluted EPS of $0.64 for the year ended December 31, 2012. The increase in net income resulted primarily from increases in net interest income and noninterest income and a decrease in the provision for loan losses, partially offset by increases in noninterest expense and income tax expense. Net income for the year ended December 31, 2011 was $2.1 million, while net income to common shareholders was $944,000, or diluted EPS of $0.22.

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

Effect of Economic Trends

Markets in the United States and elsewhere experienced extreme volatility and disruption since the latter half of 2007. While the economy as a whole has steadily improved since 2009, the weak economic conditions are expected to continue into 2014. Financial institutions likely will continue to experience credit losses above historical levels and elevated levels of non-performing assets, charge-offs and foreclosures. In light of these conditions, financial institutions also face heightened levels of scrutiny from federal and state regulators. These factors negatively influenced, and likely will continue to negatively influence, earning asset yields at a time when the market for deposits is intensely competitive. As a result, financial institutions experienced, and are expected to continue to experience, pressure on credit costs, loan yields, deposit and other borrowing costs, liquidity, and capital.

CRITICAL ACCOUNTING POLICIES

We have adopted various accounting policies that govern the application of accounting principles generally accepted in the United States of America and with general practices within the banking industry in the preparation of our financial statements. Our significant accounting policies are described in Note 1 to our Consolidated Financial Statements as of December 31, 2013.

Certain accounting policies involve significant judgments and assumptions by us that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgment and assumptions we make, actual results could differ from these judgments and estimates that could have a material impact on the carrying values of our assets and liabilities and our results of operations. Management has reviewed and approved these critical accounting policies and has discussed these policies with the Company s Audit Committee.

Allowance for Loan Losses

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

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

The allowance consists of general and specific components.

Commercial loans are assessed for estimated losses by grading each loan using various risk factors identified through periodic reviews. We apply historic grade-specific loss factors to each loan class. In the development of our statistically derived loan grade loss factors, we observe historical losses over 12 quarters for each loan grade. These loss estimates are adjusted as appropriate based on additional analysis of external loss data or other risks identified from current economic conditions and credit quality trends. For consumer loans, we determine the allowance on a collective basis utilizing historical losses over 12 quarters to represent our best estimate of inherent loss. We pool loans, generally by loan class with similar risk characteristics.

Included in the general component of the allowance for loan losses for both portfolio segments is a margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating general losses in the portfolio. Uncertainties and subjective issues such as changes in the lending policies and procedures, changes in the local/national economy, changes in volume or type of credits, changes in volume/severity or problem loans, quality of loan review and board of director oversight, concentrations of credit, and peer group comparisons are factors considered.

The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the value of the impaired loan is lower than the carrying value of that loan. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Impairment is measured on a loan by loan basis for commercial and consumer loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is

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collateral dependent. The specific component also includes an amount for the estimated impairment on commercial and consumer loans modified in a troubled debt restructuring (TDR), whether on accrual or nonaccrual status.

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowances based on their judgments about information available to them at the time of their examination.

Fair Valuation of Financial Instruments

We use fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. Additionally, we may be required to record other assets at fair value on a nonrecurring basis. These nonrecurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or write-downs of individual assets. Further, we include in the Notes to the Consolidated Financial Statements information about the extent to which fair value is used to measure assets and liabilities, the valuation methodologies used, and the related impact to income. Additionally, for financial instruments not recorded at fair value, we disclose the estimate of their fair value.

Fair value is defined as the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. Accounting standards establish a three-level hierarchy for disclosure of assets and liabilities recorded at fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable. Observable inputs reflect market-derived or market-based information obtained from independent sources, while unobservable inputs reflect our estimates about market data. The three levels of inputs that are used to classify fair value measurements are as follows:

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Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets. Level 1 instruments generally include securities traded on active exchange markets, such as the New York Stock Exchange, as well as securities that are traded by dealers or brokers in active over-the-counter markets. Instruments we classify as Level 1 are instruments that have been priced directly from dealer trading desks and represent actual prices at which such securities have traded within active markets.

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Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques, such as matrix pricing, for which all significant assumptions are observable in the market. Instruments we classify as Level 2 include securities that are valued based on pricing models that use relevant observable information generated by transactions that have occurred in the market place that involve similar securities.

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Level 3 Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company s estimates of assumptions market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models, and similar techniques.

We attempt to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. When available, we use quoted market prices to measure fair value. Specifically, we use independent pricing services to obtain fair values based on quoted prices. Quoted prices are subject to our internal price verification procedures. If market prices are not available, fair value measurement is based upon models that use

primarily market-based or independently-sourced market parameters. Most of our financial instruments use either of the foregoing methodologies, collectively Level 1 and Level 2 measurements, to determine fair value adjustments recorded to our financial statements. However, in certain cases, when market observable inputs for model-based valuation techniques may not be readily available, we are required to make judgments about assumptions market participants would use in estimating the fair value of the financial instrument.

The degree of management judgment involved in determining the fair value of an instrument is dependent upon the availability of quoted market prices or observable market parameters. For instruments that trade actively and have quoted market prices or observable market parameters, there is minimal subjectivity involved in measuring fair value. When observable market prices and parameters are not fully available, management s judgment is necessary to estimate fair value. In addition, changes in market conditions may reduce the availability of quoted prices or observable data. For example, reduced liquidity in the capital markets or changes in secondary market activities could result in observable market inputs becoming unavailable. When significant adjustments are required to available observable

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inputs, it may be appropriate to utilize an estimate based primarily on unobservable inputs. When an active market for a security does not exist, the use of management estimates that incorporate current market participant expectations of future cash flows, and include appropriate risk premiums, is acceptable.

Significant judgment may be required to determine whether certain assets measured at fair value are included in Level 2 or Level 3. If fair value measurement is based upon recent observable market activity of such assets or comparable assets (other than forced or distressed transactions) that occur in sufficient volume and do not require significant adjustment using unobservable inputs, those assets are classified as Level 2. If not, they are classified as Level 3. Making this assessment requires significant judgment.

Other-Than-Temporary Impairment Analysis

Our debt securities are classified as securities available for sale and reported at fair value. Unrealized gains and losses, after applicable taxes, are reported in shareholders equity. We conduct other-than-temporary impairment (OTTI) analysis on a quarterly basis or more often if a potential loss-triggering event occurs. The initial indicator of OTTI for debt securities is a decline in market value below the amount recorded for an investment and the severity and duration of the decline. For a debt security for which there has been a decline in the fair value below amortized cost basis, we recognize OTTI if we (1) have the intent to sell the security, (2) it is more likely than not that we will be required to

sell the security before recovery of its amortized cost basis, or (3) we do not expect to recover the entire amortized cost basis of the security.

Other Real Estate Owned

Real estate acquired through foreclosure is initially recorded at the lower of cost or estimated fair value. Subsequent to the date of acquisition, it is carried at the lower of cost or fair value, adjusted for net selling costs. Fair values of real estate owned are reviewed regularly and writedowns are recorded when it is determined that the carrying value of real estate exceeds the fair value less estimated costs to sell. Costs relating to the development and improvement of such property are capitalized, whereas those costs relating to holding the property are expensed.

Income Taxes

The financial statements have been prepared on the accrual basis. When income and expenses are recognized in different periods for financial reporting purposes versus for the purposes of computing income taxes currently payable, deferred taxes are provided on such temporary differences. Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the consolidated financial statements or tax returns. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. The Company believes that its income tax filing positions taken or expected to be taken on its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company's financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded.

RESULTS OF OPERATIONS

Net Interest Income and Margin

Our level of net interest income is determined by the level of earning assets and the management of our net interest margin. For the years ended December 31, 2013, 2012, and 2011, our net interest income was $29.0 million, $26.0 million, and $23.3 million, respectively. The $3.0 million, or 11.6%, increase in net interest income during 2013 was driven by a $63.8 million increase in average earning assets, combined with a $58.2 million increase in our average interest-bearing liabilities. The increase in average earning assets is primarily related to an increase in average loans, while the increase in average interest-bearing liabilities is driven by an increase in interest-bearing deposits. During 2012, our net interest income increased $2.7 million, or 11.6%, while average interest-earning assets increased $14.3 million and average interest-bearing liabilities decreased by $15.0 million.

Interest income for the years ended December 31, 2013, 2012, and 2011 was $36.1 million, $34.7 million, and $35.1 million, respectively. A significant portion of our interest income relates to our strategy to maintain a significant portion of our assets in higher earning loans compared to lower yielding investments and federal funds sold. As such, 94.8% of our interest income related to interest on loans during 2013, 94.1% during 2012 and 93.6% during 2011. Also, included

in interest income on loans was $692,000, $472,000 and $458,000, for the years ended December 31, 2013, 2012 and 2011, respectively, related to the net amortization of loan fees and capitalized loan origination costs.

Interest expense was $7.1 million, $8.7 million, and $11.9 million for the years ended December 31, 2013, 2012, and 2011, respectively. Interest expense on deposits for the years ended December 31, 2013, 2012 and 2011 represented 40.3%, 48.0%, and 59.0%, respectively, of total interest expense, while interest expense on borrowings represented 59.7%, 52.0%, and 41.0%, respectively, of total interest expense.

We have included a number of tables to assist in our description of various measures of our financial performance. For example, the Average Balances, Income and Expenses, Yields and Rates table shows the average balance of each category of our assets and liabilities as well as the yield we earned or the rate we paid with respect to each category during 2013, 2012, and 2011. Similarly, the Rate/Volume Analysis table demonstrates the effect of changing interest rates and changing volume of assets and liabilities on our financial condition during the periods shown. We also track the sensitivity of our various categories of assets and liabilities to changes in interest rates, and we have included tables to illustrate our interest rate sensitivity with respect to interest-earning and interest-bearing accounts.

The following table sets forth information related to our average balance sheet, average yields on assets, and average costs of liabilities at December 31, 2013, 2012 and 2011. We derived these yields or costs by dividing income or expense by the average balance of the corresponding assets or liabilities. We derived average balances from the daily balances throughout the periods indicated. During the same periods, we had no securities purchased with agreements to resell. All investments were owned at an original maturity of over one year. Nonaccrual loans are included in earning assets in the following tables. Loan yields have been reduced to reflect the negative impact on our earnings of loans on nonaccrual status. The net of capitalized loan costs and fees are amortized into interest income on loans.

Average Balances, Income and Expenses, Yields and Rates

(dollars in thousands)	For the Year Ended December 31,								
	2013			2012			2011		
	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
Interest-earning assets									
Federal funds sold	$24,6937 0.25%			$26,085	$67	0.26%	$45,498	$106	0.23%
Investment securities, taxable	551,2690 2.15%			63,169	1,419	2.25%	70,832	1,718	2.43%
Investment securities, nontaxable (1)	241,2095 5.15%			19,066	877	4.60%	13,593	687	5.05%
Loans	683,41,2492 4.98%			620,514	32,668	5.26%	584,633	32,892	5.63%
Total earning assets	793,6,5406 4.60%			728,834	35,031	4.81%	714,556	35,403	4.95%
Nonearning assets	46,986			42,900			41,931		
Total assets	$839,620			$771,734			$756,487		
Interest-bearing liabilities									
NOW accounts	$158,3203 0.25%			$152,433	881	0.58%	$140,139	1,437	1.03%
Savings & money market	146,5785 0.31%			112,323	444	0.40%	111,813	840	0.75%
Time deposits	232,0,0324 0.88%			214,743	2,852	1.33%	243,618	4,716	1.94%
Total interest-bearing deposits	528,4607 1.54%			479,499	4,177	0.87%	495,570	6,993	1.41%
FHLB advances and other borrowings	132,8959 2.93%			123,756	4,154	3.36%	122,704	4,512	3.68%
Junior subordinated debt	13,4036 2.51%			13,403	371	2.77%	13,403	349	2.60%
Total interest-bearing liabilities	674,8915 1.05%			616,658	8,702	1.41%	631,677	11,854	1.88%
Noninterest-bearing liabilities	99,774			91,022			63,384		
Shareholders equity	65,011			64,054			61,426		
Total liabilities and shareholders equity	$839,620			$771,734			$756,487		
Net interest spread			3.55%			3.40%			3.07%
Net interest income(tax equivalent)/margin		$29,403 3.71%			$26,329	3.61%		$23,549	3.30%
Less: tax-equivalent adjustment (1)		(382)			(333)			(261)	
Net interest income		$29,021			$25,996			$23,288	

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

Our net interest margin, on a tax-equivalent basis, was 3.71% for the twelve months ended December 31, 2013 compared to 3.61% for 2012, and 3.30% for 2011. The 10 basis point increase in net interest margin during 2013 as compared to the prior year, was driven primarily by a 36 basis point reduction in the cost of our interest bearing liabilities, offset in part by a 21 basis point reduction in the yield on our interest earning assets. During 2012, our net interest margin increased 31 basis points compared to the year ended 2011 due primarily to 47 basis point reduction in the cost of our interest-bearing liabilities.

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Our average interest-earning assets increased by $63.8 million compared to the 12 months ended December 31, 2013, while the yield on our interest-earning assets decreased by 21 basis points. Our average loan balances increased by $67.7 million during 2013 compared to 2012, while our loan yield decreased by 28 basis points during the same period. The decline in the yield on our interest-earning assets was driven primarily by reduced yields on our loan portfolio due to loans being originated or renewed at market rates which are lower than those in the past.

In addition, our average interest-bearing liabilities increased by $58.2 million during 2013 as compared to 2012, while the cost of our interest-bearing liabilities declined by 36 basis points. During the past 12 months, we have continued to reduce rates on all of our deposit products in line with the historically low Federal funds target rate. Also, the cost of our FHLB advances and other borrowings, including junior subordinated debt, declined by 41 basis points during 2013 as compared to 2012 due primarily to lower rates on our variable rate borrowings, combined with the restructure of $35.0 million of FHLB advances to lower rates during the past 15 months. We do not anticipate a significant reduction in the rates on our deposits or FHLB advances and other borrowings in the future, as these rates are currently at historically low rates.

Our net interest spread was 3.55% for the year ended December 31, 2013 compared to 3.40% for the same period in 2012 and 3.07% for 2011. The net interest spread is the difference between the yield we earn on our interest-earning assets and the rate we pay on our interest-bearing liabilities. The 36 basis point reduction in rate on our interest-bearing liabilities, partially offset by a 21 basis point decline in yield on our earning assets, resulted in a 15 basis point increase in our net interest spread for the 2013 period.

Rate/Volume Analysis

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

		Years Ended
	December 31, 2013 vs. 2012	December 31, 2012 vs. 2011

(dollars in thousands)	Increase (Decrease) Due to Change in				Increase (Decrease) Due to Change in			
	Volume	**Rate**	**Rate/ Volume**	**Total**	**Volume**	**Rate**	**Rate/ Volume**	**Total**
Interest income								
Loans	$3,430	(1,674)	(182)	1,574	$1,644	(1,760)	(108)	(224)
Investment securities	(65)	(88)	3	(150)	(56)	(128)	3	(181)
Federal funds sold	(2)	(2)	-	(4)	(48)	15	(6)	(39)
Total interest income	3,363	(1,764)	(179)	1,420	1,540	(1,873)	(111)	(444)
Interest expense								
Deposits	414	(1,572)	(157)	(1,315)	145	(2,901)	(60)	(2,816)
FHLB advances and other borrowings	300	(516)	(39)	(255)	39	(394)	(3)	(358)
Junior subordinated debt	-	(35)	-	(35)	-	22	-	22
Total interest expense	714	(2,123)	(196)	(1,605)	184	(3,273)	(63)	(3,152)
Net interest income	$2,649	359	17	3,025	$1,356	1,400	(48)	2,708

Net interest income, the largest component of our income, was $29.0 million for the year ended December 31, 2013, a $3.0 million increase from net interest income of $26.0 million for the year ended December 31, 2012. The increase in net interest income is due to a $1.4 million increase in interest income combined with a $1.6 million decrease in interest expense. During 2013, our average interest-earning assets increased $63.8 million as compared to 2012, resulting in $3.4 million of additional interest income; however, lower rates on our interest-earning assets reduced interest income by $1.8 million from the prior year. In addition, interest-bearing liabilities increased by $58.2 million during 2013, resulting in $714,000 of additional interest expense; however, lower rates on our interest-bearing liabilities reduced interest expense by $2.1 million from the prior year.

During the year ended December 31, 2012, our net interest income increased $2.7 million from net interest income of $23.3 million for the year ended December 31, 2011. While our average interest-earning assets increased by $14.3 million more than our average interest-bearing liabilities during 2012 as compared to the 2011 period, $3.0 million of the increase in net interest income is due to lower rates on our assets and liabilities, rather than increased balances of our interest-earning assets.

Provision for Loan Losses

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

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

			December 31,
(dollars in thousands)	**2013**	**2012**	**2011**
Balance, beginning of period	$9,091	8,925	8,386
Provision	3,475	4,550	5,270
Loan charge-offs	(2,478)	(4,505)	(4,938)
Loan recoveries	125	121	207
Net loan charge-offs	(2,353)	(4,384)	(4,731)
Balance, end of period	$10,213	9,091	8,925

For the year ended December 31, 2013, we incurred a noncash expense related to the provision for loan losses of $3.5 million, bringing the allowance for loan losses to $10.2 million, or 1.39% of gross loans, as of December 31, 2013. In comparison, we added $4.6 million and $5.3 million to the provision for loan losses during the years ended December 31, 2012 and 2011, respectively, resulting in an allowance of $9.1 million and $8.9 million at December 31, 2012 and 2011, respectively, which represented 1.41% and 1.49% of gross loans at December 31, 2012 and 2011, respectively. The lower provision expense of $3.5 million during the 2013 period relates primarily to the overall improvement in the credit quality of our loan portfolio during 2013.

During the twelve months ended December 31, 2013, our net charge-offs were $2.4 million, representing 0.34% of average loans, and consisted of $2.5 million in loans charged-off and of $125,000 of recoveries on loans previously charged-off. In addition, our loan balances increased by $91.3 million while the amount of our nonperforming and classified assets declined. Factors such as these are also considered in determining the amount of loan loss provision necessary to maintain our allowance for loan losses at an adequate level.

We reported net charge-offs of $4.4 million and $4.7 million for the years ended December 31, 2012 and 2011, respectively, including recoveries of $121,000 and $207,000 for the same periods in 2012 and 2011. The net charge-offs of $4.4 million and $4.7 million during 2012 and 2011, respectively, represented 0.71% and 0.81% of the average outstanding loan portfolios for the respective years.

Noninterest Income

The following tables set forth information related to our noninterest income.

	Year ended December 31,		
(dollars in thousands)	**2013**	**2012**	**2011**
Loan fee income	$1,235	1,044	877
Service fees on deposit accounts	879	767	638
Income from bank owned life insurance	658	632	565
Gain on sale of investment securities	-	363	23
Other than temporary impairment on investment securities	-	-	(25)
Other income	1,030	956	692
Total noninterest income	$3,802	3,762	2,770

Noninterest income was $3.8 million for the year ended December 31, 2013, a $40,000 increase over noninterest income of for the year ended December 31, 2012. The increase in total noninterest income during 2013 resulted primarily from the following:

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Loan fee income increased $191,000 or 18.3%, driven by a $177,000 increase in mortgage origination fee income which totaled $1.1 million for the year. In 2013, we expanded our mortgage operations to include full

service mortgage capabilities such as on-site underwriting, closing and funding. We expect to continue to expand in this area in order to enhance our noninterest income.

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Service fees on deposit accounts increased 14.6%, or $112,000, primarily related to increased service charge fee income on our transaction accounts. During 2013, our transaction accounts, which include checking, money market, and savings accounts, grew by $67.2 million, or 19.4%.

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Income from bank owned life insurance increased $26,000 due primarily to income earned on an additional $2.0 million of life insurance policies purchased during the second quarter of 2013.

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Other income increased by $74,000, or 7.7%, due primarily to increased fee income on our ATM and debit cards which is driven by an increase in transaction volume.

Partially offsetting the increases in noninterest income was the fact that we had no gains or losses on sale of investment securities during the current year, while during 2012 we recorded a gain on sale of investment securities of $363,000.

Noninterest income was $3.8 million for the year ended December 31, 2012, a $992,000 increase over noninterest income of $2.8 million for the year ended December 31, 2011. The largest driver of the increase in noninterest income during 2012 was a $363,000 gain on sale of investment securities. In addition, noninterest income increased during 2012 as a result of the following:

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Loan fee income increased $167,000 or 19.0%, driven primarily from increased mortgage origination fee income.

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Service fees on deposit accounts increased 20.2%, or $129,000, primarily related to increased non-sufficient funds (NSF) fee income and additional income from service charges on our checking, money market, and savings accounts.

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Other income increased by $264,000, or 38.2%, due primarily to rental income received from tenants at our Columbia, South Carolina headquarters building and additional fee income on our ATM and debit card transactions.

In accordance with the requirement set forth under the Dodd-Frank Act, in June 2011, the Federal Reserve approved a final rule which caps an issuer's base interchange fee at 21 cents per transaction and allows an additional 5 basis point charge per transaction to help cover fraud losses. Although the rule does not apply to institutions with less than $10 billion in assets, such as our Bank, there is concern that the price controls may harm community banks, which could be pressured by the marketplace to lower their own interchange rates. Our ATM/Debit card fee income is included in other noninterest income and was $560,000, $451,000, and $389,000 for the years ended December 31, 2013, 2012, and 2011, respectively, the majority of which related to interchange fee income.

Noninterest Expenses

The following tables set forth information related to our noninterest expenses.

			Years ended December 31,
(dollars in thousands)	**2013**	**2012**	**2011**
Compensation and benefits	$12,302	10,073	8,933
Occupancy	3,056	2,468	2,282
Real estate owned activity	179	939	940
Data processing and related costs	2,406	2,070	1,869
Insurance	818	1,367	1,437
Marketing	731	637	686
Professional fees	858	841	658
Other	1,462	1,118	1,062
Total noninterest expenses	$21,812	19,513	17,867

Noninterest expense was $21.8 million for the year ended December 31, 2013, a $2.3 million, or 11.8%, increase from noninterest expense of $19.5 million for 2012.

The increase in total noninterest expenses resulted primarily from the following:

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Compensation and benefits expense increased $2.2 million, or 22.1%, during 2013 relating primarily to increases in base and incentive compensation and benefits expenses. Base compensation expense increased by $1.4 million driven by the cost of 13 additional employees five of whom were hired to assist with our expanded mortgage capabilities with the remainder being hired to support our growth in loans and deposits, combined with annual salary increases. Incentive compensation, which is based on certain targeted financial

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performance goals met by management, increased by $260,000, while benefits expenses increased $614,000 during the 2013 period and represented 21.6% of total compensation and benefits during 2013.

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Occupancy expenses increased 23.8%, or $588,000, driven primarily by increased depreciation, utilities, rent, and property tax expenses related primarily to our two new offices in Charleston and Columbia, South Carolina.

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Data processing and related costs increased 16.2%, or $336,000, primarily related to the increased number of clients and accounts we service.

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Marketing expenses increased $94,000, or 14.8%, driven by increased advertising, community sponsorships and business development costs, including additional costs associated with our entry into the Charleston, South Carolina market.

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Other noninterest expenses increased by 30.8%, or $344,000, primarily related to additional costs associated with our mortgage and office expansions, as well as increased travel and collection expenses.

Partially, offsetting the increases in noninterest expenses was a $760,000, or 80.9%, decrease in real estate owned activity which includes expenses related to the management of properties we hold for sale. In addition, insurance expense decreased by $549,000, or 40.2%, due to a reduction in FDIC insurance premiums and a reduction in regulator fees resulting from the Bank s change from a national charter to a South Carolina charter.

Noninterest expense for the years ended December 31, 2012 and 2011 was $19.5 million and $17.9 million, respectively.

The $1.6 million increase during 2012 related primarily to the following:

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Compensation and benefits expense increased $1.1 million, or 12.8%, during 2012 relating primarily to increases in base and incentive compensation expenses and benefits expense. Base compensation expense increased by $664,000 driven by the cost of 12 additional employees most of whom were hired to support our new Charleston and Forest Drive offices, combined with annual salary increases. Incentive compensation increased by $220,000, while benefits expenses increased $276,000 during the 2012 period and represented 20.3% of total compensation and benefits during 2012.

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Occupancy expenses increased 8.2%, or $186,000, driven primarily by increased depreciation, utilities, and repairs and maintenance expenses.

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Data processing and related costs increased 10.8%, or $201,000, primarily related to the increased number of clients and accounts we service.

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Professional fees increased $183,000, or 27.8%, driven by increased legal and accounting expenses and loan appraisal fees during the 2012 period. Of the $841,000 in professional fees during 2012, approximately $130,000 was related to expenses associated with the sale of our Series T Preferred stock by the Treasury in the TARP auction in June 2012 and repurchase of the CPP Warrant in July 2012.

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Other noninterest expenses increased by 5.3%, or $56,000, driven by increased travel and other costs associated with opening our two new retail offices.

Partially offsetting the increases in noninterest expenses was a $70,000, or 4.9%, decrease in insurance expense due to the change in the assessment base calculation for FDIC insurance which took place in the second quarter of 2011.

Our efficiency ratio, excluding gains on sale of investment securities and real estate owned activity, was 65.9% for 2013 compared to 63.2% for 2012. The efficiency ratio represents the percentage of one dollar of expense required to be incurred to earn a full dollar of revenue and is computed by dividing noninterest expense by the sum of net interest income and noninterest income. The higher efficiency ratio during 2013 relates primarily to the increase in noninterest expense due to the additional costs associated with opening our two new retail locations and expanding our mortgage operations capabilities.

Income tax expense was $2.4 million, $1.8 million and $833,000 for the years ended December 31, 2013, 2012 and 2011, respectively. The increase in income tax expense in 2013 was primarily a result of the increase in our net income. Our effective tax rate was 32.1% for the year ended December 31, 2013, and 32.2% and 28.5% for the years ended December 31, 2012 and 2011, respectively. The lower net income during 2011, combined with additional tax-exempt income from bank owned life insurance and state and municipal investment securities, increased the impact that our tax-exempt income had in lowering our effective tax rate.

Investment Securities

At December 31, 2013, the $73.6 million in our investment securities portfolio represented approximately 8.3% of our total assets. Our investment portfolio included U.S. agency securities, SBA securities, state and political subdivisions,

and mortgage-backed securities with a fair value of $67.4 million and an amortized cost of $69.5 million for an unrealized loss of $2.0 million.

The amortized costs and the fair value of our investments are as follows.

						December 31,
	2013		2012		2011	
(dollars in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for Sale						
US government agencies	$8,756	7,755	7,781	7,785	-	-
SBA securities	5,758	5,271	6,060	6,072	-	-
State and political subdivisions	23,622	23,370	24,167	25,249	17,390	18,248
Mortgage-backed securities	31,347	31,044	38,428	39,116	81,694	82,412
Total	$69,483	67,440	76,436	78,222	99,084	100,660

Contractual maturities and yields on our investments are shown in the following table. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

										December 31, 2013
	Less Than One Year		One to Five Years		Five to Ten Years		Over Ten Years		Total	
(dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for Sale										
US government agencies	$-	-	$-	-	$956	2.13%	$6,799	2.43%	$7,755	2.40%
SBA securities	-	-	-	-	-	-	5,271	1.88%	5,271	1.88%
	1,507	0.51%	2,114	0.67%	7,398	3.22%	12,351	2.88%	23,370	2.63%

State and political subdivisions										
Mortgage-backed securities	-	-	-	-	2,072	1.77%	28,972	2.69%	31,044	2.62%
Total	$1,507	0.51%	$2,114	0.67%	$10,426	2.82%	$53,393	2.61%	$67,440	2.54%

At December 31, 2013, the Company had 35 individual investments with a fair market value of $32.4 million that were in an unrealized loss position for less than 12 months and 11 individual investments with a fair market value of $9.0 million that were in an unrealized loss position for 12 months or longer. The unrealized losses were primarily attributable to changes in interest rates, rather than deterioration in credit quality. The individual securities are each investment grade securities. The Company considers the length of time and extent to which the fair value of available-for-sale debt securities have been less than cost to conclude that such securities were not other-than-temporarily impaired. We also consider other factors such as the financial condition of the issuer including credit ratings and specific events affecting the operations of the issuer, volatility of the security, underlying assets that collateralize the debt security, and other industry and macroeconomic conditions. As the Company has no intent to sell securities with unrealized losses and it is not more-likely-than-not that the Company will be required to sell these securities before recovery of amortized cost, we have concluded that the securities are not impaired on an other-than-temporary basis.

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

	December 31,	
(dollars in thousands)	**2013**	**2012**
Federal Reserve Bank stock	$-	1,485
Federal Home Loan Bank stock	5,614	5,807
Certificates of deposit	99	99
Investment in Trust Preferred subsidiaries	403	403
Total	$6,116	7,794

Loans

Since loans typically provide higher interest yields than other types of interest-earning assets, a substantial percentage of our earning assets are invested in our loan portfolio. Average loans for the years ended December 31, 2013 and 2012 were $688.2 million and $620.5 million, respectively. Before allowance for loan losses, total loans outstanding at December 31, 2013 and 2012 were $737.3 million and $646.0 million, respectively.

The principal component of our loan portfolio is loans secured by real estate mortgages. As of December 31, 2013, our loan portfolio included $594.6 million, or 80.6%, of real estate loans. As of December 31, 2012, loans secured by real estate made up 80.9% of our loan portfolio and totaled $522.5 million. Most of our real estate loans are secured by residential or commercial property. In addition, included in our consumer real estate loan portfolio are $3.6 million and $2.1 million as of December 31, 2013 and 2012, respectively, of mortgage loans held for sale. We obtain a security interest in real estate, in addition to any other available collateral. This collateral is taken to increase the likelihood of the ultimate repayment of the loan. Generally, we limit the loan-to-value ratio on loans to coincide with the appropriate regulatory guidelines. We attempt to maintain a relatively diversified loan portfolio to help reduce the risk inherent in concentration in certain types of collateral and business types. We do not generally originate traditional long term residential mortgages to hold in our loan portfolio, but we do issue traditional second mortgage residential real estate loans and home equity lines of credit. Home equity lines of credit totaled $78.5 million as of December 31, 2013, of which approximately 37% were in a first lien position, while the remaining balance was second liens, compared to $77.9 million as of December 31, 2012, with approximately 38% in first lien positions. The average loan had a balance of approximately $105,000 and a loan to value of approximately 67% as of December 31, 2013, compared to an average loan balance of $106,000 and a loan to value of approximately 75% as of December 31, 2012. Further, 0.1% and 0.6% of our total home equity lines of credit were over 30 days past due as of December 31, 2013 and 2012, respectively.

Following is a summary of our loan composition for each of the five years ended December 31, 2013. Of the $91.3 million in loan growth, $59.4 million is related to our new office in the Charleston, South Carolina market with growth of $16.6 million in non-owner occupied real estate, $17.4 million in owner occupied real estate, $6.9 million in commercial construction and $14.1 million in commercial business loans. In addition, the $27.6 million increase in consumer real estate loans is related to our focus to continue to originate high quality 1-4 family consumer real estate loans. Our average consumer real estate loan currently has a principal balance of $304,000, a term of eight years, and an average rate of 4.56%.

	December 31,									
	2013		**2012**		**2011**		**2010**		**2009**	
		% of		**% of**		**% of**		**% of**		**%o**
lars in thousands)	**Amount**	**Total**	**Amount**	**Total**	**Amount**	**Total**	**Amount**	**Total**	**Amount**	**Tot**
nmercial										
wner occupied RE	$185,129	25.1%	$158,790	24.6%	$149,254	24.9%	$137,696	24.0%	$132,328	23.0
on-owner occupied RE	166,016	22.5%	165,163	25.6%	164,623	27.5%	163,795	28.6%	160,229	27.9
onstruction	30,906	4.2%	20,347	3.1%	17,841	3.0%	11,319	2.0%	22,718	4.0%
usiness	129,687	17.6%	114,169	17.7%	111,831	18.7%	109,351	19.1%	110,438	19.2

Total commercial loans	511,738	69.4%	458,469	71.0%	443,549	74.1%	422,161	73.7%	425,713	74.1
nsumer										
eal estate	114,201	15.5%	86,559	13.4%	57,798	9.7%	54,076	9.5%	55,277	9.6
ome equity	78,479	10.6%	77,895	12.1%	82,664	13.8%	79,528	13.9%	74,348	13.0
onstruction	19,888	2.7%	13,749	2.1%	5,546	0.9%	8,550	1.5%	7,914	1.4
ther	12,961	1.8%	9,277	1.4%	9,077	1.5%	8,077	1.4%	11,018	1.9
Total consumer loans	225,529	30.6%	187,480	29.0%	155,085	25.9%	150,231	26.3%	148,557	25.9
Total gross loans, net of deferred fees	737,267	100.0%	645,949	100.0%	598,634	100.0%	572,392	100.0%	574,270	100
s allowance for loan losses	(10,213)		(9,091)		(8,925)		(8,386)		(7,760)	
Total loans, net	$727,054		$636,858		$589,709		$564,006		$566,510	

Maturities and Sensitivity of Loans to Changes in Interest Rates

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

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The following table summarizes the loan maturity distribution by type and related interest rate characteristics.

	December 31, 2013			
(dollars in thousands)	**One year or less**	**After one but within five years**	**After five years**	**Total**
Commercial				
Owner occupied RE	$26,959	93,377	64,793	185,129
Non-owner occupied RE	45,937	96,891	23,188	166,016
Construction	11,619	13,844	5,443	30,906
Business	63,720	58,780	7,187	129,687

Total commercial loans	148,235	262,892	100,611	511,738
Consumer				
Real estate	18,397	34,068	61,736	114,201
Home equity	4,988	26,319	47,172	78,479
Construction	11,749	1,709	6,430	19,888
Other	6,451	5,334	1,176	12,961
Total consumer loans	41,585	67,430	116,514	225,529
Total gross loan, net of deferred fees	$189,820	330,322	217,125	737,267
Loans maturing after one year with				
Fixed interest rates				380,476
Floating interest rates				166,971

Nonperforming Assets

Nonperforming assets include real estate acquired through foreclosure or deed taken in lieu of foreclosure and loans on nonaccrual status. The following table shows the nonperforming assets and the related percentage of nonperforming assets to total assets and gross loans for the five years ended December 31, 2013. Generally, a loan is placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when we believe, after considering economic and business conditions and collection efforts, that the borrower s financial condition is such that collection of the loan is doubtful. A payment of interest on a loan that is classified as nonaccrual is recognized as a reduction in principal when received. Our policy with respect to nonperforming loans requires the borrower to make a minimum of six consecutive payments in accordance with the loan terms before that loan can be placed back on accrual status. Further, the borrower must show capacity to continue performing into the future prior to restoration of accrual status. As of December 31, 2013 and 2012, we had no loans 90 days past due and still accruing.

	December 31,				
(dollars in thousands)	**2013**	**2012**	**2011**	**2010**	**2009**
Commercial					
Owner occupied RE	$1,199	155	1,061	1,183	736
Non-owner occupied RE	373	1,255	1,745	3,311	2,560
Construction	914	1,006	1,314	1,377	1,483
Business	712	202	503	1,781	3,351
Consumer					
Real estate	76	119	476	928	2,551
Home equity	77	577	386	251	503
Construction	-	-	-	-	-
Other	3	44	-	7	75
Nonaccruing troubled debt restructurings	4,983	4,809	4,779	488	482

Total nonaccrual loans, including nonaccruing TDRs	8,337	8,167	10,264	9,326	11,741
Other real estate owned	1,198	1,719	3,686	5,629	3,704
Total nonperforming assets	$9,535	$9,886	13,950	14,955	15,445
Nonperforming assets as a percentage of:					
Total assets	1.07%	1.24%	1.82%	2.03%	2.15%
Gross loans	1.29%	1.53%	2.33%	2.61%	2.69%
Total loans over 90 days past due (1)	$6,493	5,027	8,854	6,439	4,686
Loans over 90 days past due and still accruing	-	-	-	-	-
Accruing troubled debt restructurings	8,045	9,421	7,429	-	-

(1) Loans over 90 days are included in nonaccrual loans

At December 31, 2013, nonperforming assets were $9.5 million, or 1.07% of total assets and 1.29% of gross loans. Comparatively, nonperforming assets were $9.9 million, or 1.24% of total assets and 1.53% of gross loans, at December 31, 2012. Nonaccrual loans increased $170,000 to $8.3 million at December 31, 2013 from $8.2 million at December 31, 2012. During 2013, we added $5.2 million or nine new loans to nonaccrual while removing or charging off $801,000 or seven nonaccrual loans from 2012 and transferring two properties totaling $1.3 million to real estate acquired in settlement of loans. In addition, 14 loans, or $2.1 million, were either paid off or returned to accrual status during 2013. The amount of foregone interest income on the nonaccrual loans for the years ended December 31, 2013 and 2012 was approximately $543,000 and $402,000, respectively.

Nonperforming assets include other real estate owned. These assets decreased $521,000 to $1.2 million at December 31, 2013 from $1.7 million at December 31, 2012. During 2013, we sold six properties for approximately $1.7 million and recognized a $5,000 loss on the sales. In addition, we added three properties to other real estate owned during 2013 for $1.4 million, and recorded write-downs on three properties of $130,000. The balance at December 31, 2013 includes three commercial properties for $1.1 million and three residential real estate properties totaling $105,000. We believe that these properties are appropriately valued at the lower of cost or market as of December 31, 2013.

At December 31, 2013, 2012 and 2011, the allowance for loan losses represented 122.5%, 111.3%, and 87.0% of the amount of non-performing loans. A significant portion, or 92.8%, of nonperforming loans at December 31, 2013 are secured by real estate. Our nonperforming loans have been written down to approximately 68% of their original nonperforming balance. We have evaluated the underlying collateral on these loans and believe that the collateral on these loans combined with our write-downs on these loans is sufficient to minimize future losses. As a result of this level of coverage on non-performing loans, we believe the provision of $3.5 million for the year ended December 31, 2013 to be adequate.

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

In addition, approximately 81% of our loans are collateralized by real estate and over 88% of our impaired loans are secured by real estate. The Bank utilizes third party appraisers to determine the fair value of collateral dependent loans. Our current loan and appraisal policies require the Bank to obtain updated appraisals on an annual basis, either through a new external appraisal or an internal appraisal evaluation. Impaired loans are individually reviewed on a quarterly basis to determine the level of impairment. As of December 31, 2013, we do not have any impaired loans carried at a value in excess of the appraised value. We typically charge-off a portion or create a specific reserve for impaired loans when we do not expect repayment to occur as agreed upon under the original terms of the loan agreement.

At December 31, 2013, impaired loans totaled approximately $16.6 million for which $14.1 million of these loans have a reserve of approximately $4.7 million allocated in the allowance. During 2013, the average recorded investment in impaired loans was approximately $16.1 million. At December 31, 2012, impaired loans totaled approximately $17.6 million for which $9.5 million of these loans had a reserve of approximately $3.7 million allocated in the allowance. During 2012, the average recorded investment in impaired loans was approximately $17.9 million.

The Company considers a loan to be a troubled debt restructuring (TDR) when the debtor experiences financial difficulties and the Company provides concessions such that we will not collect all principal and interest in accordance with the original terms of the loan agreement. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of our workout plan for individual loan relationships, we may restructure loan terms to assist borrowers facing challenges in the current economic environment. As of December 31, 2013, we determined that we had loans totaling $13.0 million, which we considered TDRs. As of December 31, 2012, we had loans totaling $14.2 million, which we considered TDRs. See Notes 1 and 4 to the Consolidated Financial Statements for additional information on TDRs.

Allowance for Loan Losses

At December 31, 2013 and December 31, 2012, the allowance for loan losses was $10.2 million and $9.1 million, respectively, or 1.39% and 1.41% of outstanding loans, respectively. The allowance for loan losses as a percentage of our outstanding loan portfolio decreased primarily as a result of the overall improvement in the credit quality of our loan portfolio during 2013. During the year ended December 31, 2013, our net charged-off loans decreased by $2.0 million and our total nonaccrual loans increased by $170,000, as compared to the year ended December 31, 2012. See Note 3 to the Consolidated Financial Statements for more information on our allowance for loan losses.

The following table summarizes the activity related to our allowance for loan losses for the five years ended December 31, 2013.

	Year ended December 31,				
(dollars in thousands)	**2013**	**2012**	**2011**	**2010**	**2009**
Balance, beginning of period	$9,091	8,925	8,386	7,760	7,005
Provision for loan losses	3,475	4,550	5,270	5,610	4,310
Loan charge-offs:					
Commercial					
Owner occupied RE	(390)	(1,857)	(72)	(143)	-
Non-owner occupied RE	(249)	(513)	(1,052)	(1,343)	(482)
Construction	-	-	(67)	-	(1,096)
Business	(1,664)	(1,230)	(3,243)	(2,982)	(1,741)
Total commercial	(2,303)	(3,600)	(4,434)	(4,468)	(3,319)
Consumer					
Real estate	(22)	(214)	(129)	(235)	(117)
Home equity	(106)	(691)	(175)	(286)	(94)
Construction	-	-	-	-	-
Other	(47)	-	(200)	(171)	(134)
Total consumer	(175)	(905)	(504)	(692)	(345)
Total loan charge-offs	(2,478)	(4,505)	(4,938)	(5,160)	(3,664)
Loan recoveries:					
Commercial					
Owner occupied RE	1	4	14	1	-
Non-owner occupied RE	1	42	42	-	14
Construction	-	-	-	-	-
Business	115	27	149	167	92
Total commercial	117	73	205	168	106
Consumer					

Real estate	-	2	-	4	-
Home equity	8	32	2	3	-
Construction	-	-	-	-	-
Other	-	14	-	1	3
Total consumer	8	48	2	8	3
Total recoveries	125	121	207	176	109
Net loan charge-offs	(2,353)	(4,384)	(4,731)	(4,984)	(3,555)
Balance, end of period	$10,213	9,091	8,925	8,386	7,760
Allowance for loan losses to gross loans	1.39%	1.41%	1.49%	1.47%	1.35%
Net charge-offs to average loans	0.34%	0.71%	0.81%	0.86%	0.63%

Deposits and Other Interest-Bearing Liabilities

Our primary source of funds for loans and investments is our deposits, advances from the FHLB, and structured repurchase agreements. In the past, we have chosen to obtain a portion of our certificates of deposits from areas outside of our market in order to obtain longer term deposits than are readily available in our local market. We have adopted guidelines regarding our use of brokered CDs that limit our brokered CDs to 25% of total deposits and dictate that our current interest rate risk profile determines the terms. In addition, we do not obtain time deposits of $100,000 or more through the Internet. These guidelines allow us to take advantage of the attractive terms that wholesale funding can offer while mitigating the related inherent risk.

Our retail deposits represented $617.0 million, or 90.7% of total deposits at December 31, 2013, while our out-of-market, or brokered, deposits represented $63.3 million, or 9.3% of our total deposits at December 31, 2013. At December 31, 2012, retail deposits represented $563.3 million, or 97.7% of our total deposits, and brokered CDs were $13.0 million, representing 2.3% of our total deposits, at December 31, 2013. While our total retail deposits increased by $53.7 million during the 2013 period, the retail deposit balances for our two new retail offices, which were opened in December 2012, increased by $51.9 million. In addition, we secured an additional $50.3 million of brokered deposits during the year ended December 31, 2013 in order to fund the $90.2 million of net loan growth. Our loan-to-deposit ratio was 108%, 112%, and 106% at December 31, 2013, 2012, and 2011, respectively.

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

	December 31,					
	2013		2012		2011	
(dollars in thousands)	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest bearing demand deposits	$93,378	-%	$86,080	-%	$58,573	-%
Interest bearing demand deposits	152,238	0.25%	152,433	0.58%	140,139	1.03%
Money market accounts	139,877	0.32%	107,052	0.41%	107,960	0.77%
Savings accounts	6,308	0.09%	5,271	0.13%	3,853	0.18%
Time deposits less than $100,000	70,144	0.81%	75,148	1.10%	75,912	1.57%
Time deposits greater than $100,000	159,910	0.73%	139,595	1.45%	167,706	2.10%
Total deposits	$621,855	0.41%	$565,579	0.74%	$554,143	1.27%

During the 12 months ended December 31, 2013, our average transaction account balances increased by $41.0 million, or 11.7%, while our average time deposit balances increased by $15.3 million, or 7.1%, due primarily to a $9.3 million increase in average brokered deposits from the previous 12 month period. In addition, during 2013, as our interest-bearing deposits repriced, we were able to reduce the rates we paid on these deposits; however, we do not anticipate a significant reduction in our deposit costs in the future.

During the past 12 months, we continued our focus on increasing core deposits, which exclude out-of-market deposits and time deposits of $100,000 or more, in order to provide a relatively stable funding source for our loan portfolio and other earning assets. Our core deposits were $481.8 million, $427.9 million, and $413.1 million at December 31, 2013, 2012 and 2011, respectively. Included in time deposits of $100,000 or more at December 31, 2013 is $39.1 million of wholesale CDs scheduled to mature within the next 12 months at a weighted average rate of 0.76%.

All of our time deposits are certificates of deposits. The maturity distribution of our time deposits of $100,000 or more is as follows:

	December 31,	
(dollars in thousands)	2013	2012
Three months or less	$25,892	47,713
Over three through six months	28,157	32,056
Over six through twelve months	63,659	36,396
Over twelve months	80,644	32,198
Total	$198,352	148,363

Liquidity and Capital Resources

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

At December 31, 2013 and 2012, our liquid assets amounted to $39.2 million and $29.4 million, or 4.4% and 3.7% of total assets, respectively. Our investment securities at December 31, 2013 and 2012 amounted to $73.6 million and $86.0 million, or 8.3% and 10.8% of total assets, respectively. Investment securities traditionally provide a secondary

source of liquidity since they can be converted into cash in a timely manner. However, approximately 33% of these securities are pledged against outstanding debt. Therefore, the related debt would need to be repaid prior to the securities being sold in order for these securities to be converted to cash. In addition, approximately 37% of our investment securities are pledged to secure client deposits.

Our ability to maintain and expand our deposit base and borrowing capabilities serves as our primary source of liquidity. We plan to meet our future cash needs through the liquidation of temporary investments, the generation of deposits, and from additional borrowings. In addition, we will receive cash upon the maturity and sale of loans and the maturity of investment securities. We maintain three federal funds purchased lines of credit with correspondent banks totaling $45.0 million for which there were no borrowings against the lines at December 31, 2013.

We are also a member of the FHLB of Atlanta, from which applications for borrowings can be made. The FHLB requires that securities, qualifying mortgage loans, and stock of the FHLB owned by the Bank be pledged to secure any advances from the FHLB. The unused borrowing capacity currently available from the FHLB at December 31, 2013 was $69.8 million, based on the Bank s $5.6 million investment in FHLB stock, as well as qualifying mortgages available to secure any future borrowings. However, we are able to pledge additional securities to the FHLB in order to increase our available borrowing capacity.

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

Total shareholders equity was $65.7 million at December 31, 2013 and $64.1 million at December 31, 2012. The $1.5 million increase during 2013 is primarily related to net income of $5.1 million for 2013, offset partially by the $1.0 million repurchase of 1,000 shares of our Series T Preferred stock and $2.5 million decline in accumulated other comprehensive income.

The following table shows the return on average assets (net income divided by average total assets), return on average equity (net income divided by average equity), and equity to assets ratio (average equity divided by average total assets) for the three years ended December 31, 2013. Since our inception, we have not paid cash dividends.

	December 31,		
(dollars in thousands)	**2013**	**2012**	**2011**
Return on average assets	0.61%	0.50%	0.28%
Return on average equity	7.88%	6.03%	3.40%
Return on average common equity	8.81%	5.79%	2.10%
Average equity to average assets ratio	7.74%	8.30%	8.12%
Common equity to assets ratio	5.65%	5.99%	5.98%

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

At both the holding company and Bank level, we are subject to various regulatory capital requirements administered by the federal banking agencies. To be considered well-capitalized, we must maintain total risk-based capital of at least 10%, Tier 1 capital of at least 6%, and a leverage ratio of at least 5%. To be considered adequately capitalized under these capital guidelines, we must maintain a minimum total risk-based capital of 8%, with at least 4% being Tier 1 capital. In addition, we must maintain a minimum Tier 1 leverage ratio of at least 4%. As of December 31, 2013, our capital ratios exceed these ratios and we remain well capitalized.

In July 2013, the FDIC approval of a final rule to implement the Basel III regulatory capital reforms among other changes required by the Dodd-Frank Act. The framework requires banking organizations to hold more and higher quality capital, which acts as a financial cushion to absorb losses, taking into account the impact of risk. The approved

rule includes a new minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5% as well as a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The rule also raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and includes a minimum leverage ratio of 4% for all banking institutions. For the largest, most internationally active banking organizations, the rule includes a new minimum supplementary leverage ratio that takes into account off-balance sheet exposures. In terms of quality of capital, the final rule emphasizes common equity Tier 1 capital and implements strict eligibility criteria for regulatory capital instruments. It also changes the methodology for calculating risk-weighted assets to enhance risk sensitivity. The changes begin to take effect for the Bank in January 2015. The ultimate impact of the new capital standards on the Company and the Bank is currently being reviewed.

The following table summarizes the capital amounts and ratios of the Bank and the regulatory minimum requirements. See Note 21 to the Consolidated Financial Statements for ratios of the Holding Company.

	Actual		**For capital adequacy purposes minimum**		**To be well capitalized under prompt corrective action provisions minimum**	
(dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2013						
Total Capital (to risk weighted assets)	$88,674	12.2%	$58,381	8.0%	$72,976	10.0%
Tier 1 Capital (to risk weighted assets)	79,538	10.9%	29,191	4.0%	43,786	6.0%
Tier 1 Capital (to average assets)	79,538	9.1%	34,989	4.0%	43,737	5.0%
As of December 31, 2012						
Total Capital (to risk weighted assets)	$83,763	13.0%	$51,498	8.0%	$64,372	10.0%
Tier 1 Capital (to risk weighted assets)	75,704	11.8%	25,749	4.0%	38,623	6.0%
Tier 1 Capital (to average assets)	75,704	9.6%	31,492	4.0%	39,366	5.0%

As of December 31, 2011						
Total Capital (to risk weighted assets)	$80,885	13.1%	$49,397	8.0%	$61,746	10.0%
Tier 1 Capital (to risk weighted assets)	73,152	11.9%	24,698	4.0%	37,047	6.0%
Tier 1 Capital (to average assets)	73,152	9.5%	30,920	4.0%	38,651	5.0%

The ability of the Company to pay cash dividends is dependent upon receiving cash in the form of dividends from the Bank. The dividends that may be paid by the Bank to the Company are subject to legal limitations and regulatory capital requirements. Further, the Company cannot pay cash dividends on its common stock during any calendar quarter unless full dividends on the Series T preferred stock for the dividend period ending during the calendar quarter have been declared and the Company has not failed to pay a dividend in the full amount of the Series T preferred stock with respect to the period in which such dividend payment in respect of its common stock would occur.

Effect of Inflation and Changing Prices

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

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

Off-Balance Sheet Risk

Commitments to extend credit are agreements to lend to a client as long as the client has not violated any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At December 31, 2013, unfunded commitments to extend credit were approximately $138.7 million, of which $32.6 million is at fixed rates and $106.1 million is at variable rates. At December 31, 2012, unfunded commitments to extend credit were $115.6 million, of which approximately $22.1 million

was at fixed rates and $93.5 million was at variable rates. A significant portion of the unfunded commitments related to consumer equity lines of credit. Based on historical experience, we anticipate that a significant portion of these lines of credit will not be funded. We evaluate each client s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on our credit evaluation of the borrower. The type of collateral varies but may include accounts receivable, inventory, property, plant and equipment, and commercial and residential real estate.

At December 31, 2013 and 2012, there was a $3.0 million and $2.3 million commitment under letters of credit, respectively. The credit risk and collateral involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to clients. Since most of the letters of credit are expected to expire without being drawn upon, they do not necessarily represent future cash requirements.

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

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

Market Risk and Interest Rate Sensitivity

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

We actively monitor and manage our interest rate risk exposure in order to control the mix and maturities of our assets and liabilities utilizing a process we call asset/liability management. The essential purposes of asset/liability management are to ensure adequate liquidity and to maintain an appropriate balance between interest sensitive assets and liabilities in order to minimize potentially adverse impacts on earnings from changes in market interest rates. Our

asset/liability management committee (ALCO) monitors and considers methods of managing exposure to interest rate risk. We have both an internal ALCO consisting of senior management that meets at various times during each month and a board ALCO that meets monthly. The ALCOs are responsible for maintaining the level of interest rate sensitivity of our interest sensitive assets and liabilities within board-approved limits.

As of December 31, 2013, the following table summarizes the forecasted impact on net interest income using a base case scenario given upward and downward movements in interest rates of 100, 200, and 300 basis points based on forecasted assumptions of prepayment speeds, nominal interest rates and loan and deposit repricing rates. Estimates are based on current economic conditions, historical interest rate cycles and other factors deemed to be relevant. However, underlying assumptions may be impacted in future periods which were not known to management at the time of the issuance of the Consolidated Financial Statements. Therefore, management s assumptions may or may not prove valid. No assurance can be given that changing economic conditions and other relevant factors impacting our net interest income will not cause actual occurrences to differ from underlying assumptions. In addition, this analysis does not consider any strategic changes to our balance sheet which management may consider as a result of changes in market conditions.

Interest rate scenario	**Change in net interest income from base**
Up 300 basis points	9.96%
Up 200 basis points	5.93%
Up 100 basis points	2.64%
Base	-
Down 100 basis points	(4.25)%
Down 200 basis points	(8.22)%
Down 300 basis points	(10.36)%

Contractual Obligations

We utilize a variety of short-term and long-term borrowings to supplement our supply of lendable funds, to assist in meeting deposit withdrawal requirements, and to fund growth of interest-earning assets in excess of traditional deposit growth. Certificates of deposit, structured repurchase agreements, FHLB advances, and junior subordinate debentures

serve as our primary sources of such funds.

Obligations under noncancelable operating lease agreements are payable over several years with the longest obligation expiring in 2025. We do not feel that any existing noncancelable operating lease agreements are likely to materially impact the Company s financial condition or results of operations in an adverse way. Contractual obligations relative to these agreements are noted in the table below. Option periods that we have not yet exercised are not included in this analysis as they do not represent contractual obligations until exercised.

The following table provides payments due by period for obligations under long-term borrowings and operating lease obligations as of December 31, 2013. In addition, the Company has a contract with a construction company for $1.3 million to construct a new office building in Mt. Pleasant, South Carolina.

(dollars in thousands)	**December 31, 2013 Payments Due by Period**					
	Within One Year	**Over One to Two Years**	**Over Two to Three Years**	**Over Three to Five Years**	**After Five Years**	**Total**
Certificates of deposit	$165,405	68,309	18,808	13,925	95	266,542
FHLB advances and other borrowings	8,900	-	44,500	45,700	25,000	124,100
Junior subordinated debentures	-	-	-	-	13,403	13,403
Operating lease obligations	776	795	794	269	1,129	3,763
Total	$175,081	69,104	64,102	59,894	39,627	407,808

Accounting, Reporting, and Regulatory Matters

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by the Company.

The Balance Sheet topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) was amended in December 2011 for companies with financial instruments and derivative instruments that offset or are subject to a master netting agreement. The amendments require disclosure of both gross information and net information about instruments and transactions eligible for offset or subject to an agreement similar to a master netting agreement. The amendments were effective for reporting periods beginning on or after January 1, 2013 and required retrospective presentation for all comparative periods presented. Additionally, in January 2013 the FASB clarified that the amendments apply only to derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria

contained in U.S. GAAP or subject to a master netting arrangement or similar agreement. These amendments did not have a material effect on the Company s financial statements.

The Comprehensive Income topic of the ASC was amended in June 2011. The amendment eliminated the option to present other comprehensive income as a part of the statement of changes in stockholders equity and required consecutive presentation of the statement of net income and other comprehensive income. The amendments were applicable to the Company January 1, 2012 and have been applied retrospectively. In December 2011, the topic was further amended to defer the effective date of presenting reclassification adjustments from other comprehensive income to net income on the face of the financial statements while the FASB redeliberated the presentation requirements for the reclassification adjustments. In February 2013, the FASB further amended the Comprehensive Income topic clarifying the conclusions from such redeliberations. Specifically, the amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments do require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, in certain circumstances an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amendments were effective for the Company on a prospective basis for reporting periods beginning after December 15, 2012. These amendments did not have a material effect on the Company s financial statements.

In April 2013, the FASB issued guidance addressing application of the liquidation basis of accounting. The guidance is intended to clarify when an entity should apply the liquidation basis of accounting. In addition, the guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. The amendments will be effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein and those requirements should be applied prospectively from the day that liquidation becomes imminent. Early adoption is permitted. The Company does not expect these amendments to have any effect on its financial statements.

In December 2013, the FASB amended the Master Glossary of the FASB Codification to define Public Business Entity to minimize the inconsistency and complexity of having multiple definitions of, or a diversity in practice as to what constitutes, a nonpublic entity and public entity within U.S. GAAP. The amendment does not affect existing requirements, however will be used by the FASB, the Private Company Council (PCC), and the Emerging Issues Task Force (EITF) in specifying the scope of future financial accounting and reporting guidance. The Company does not expect this amendment to have any effect on its financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a significant impact on the Company s financial position, results of operations and cash flows.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Market Risk and Interest Rate Sensitivity and Liquidity and Capital Resources.

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Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

To the Board of Directors

Southern First Bancshares, Inc. and Subsidiary

Greenville, South Carolina

We have audited the accompanying consolidated balance sheets of Southern First Bancshares, Inc. and Subsidiary as

of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, shareholders equity, and cash flows for each of the years in the three year period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southern First Bancshares, Inc. and Subsidiary as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

/s/ Elliott Davis, LLC

Greenville, South Carolina

March 4, 2014

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except share data)	**December 31,** **2013**	**2012**
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$12,361	13,063
Federal funds sold	8,541	-
Interest-bearing deposits with banks	18,301	16,350
Total cash and cash equivalents	39,203	29,413
Investment securities:		
Investment securities available for sale	67,440	78,222
Other investments	6,116	7,794
Total investment securities	73,556	86,016
Loans	737,267	645,949
Less allowance for loan losses	(10,213)	(9,091)
Loans, net	727,054	636,858
Bank owned life insurance	21,383	18,725
Property and equipment, net	19,827	18,733
Deferred income taxes, net	4,938	3,176
Other assets	4,870	5,077
Total assets	$890,831	797,998
LIABILITIES		
Deposits	$680,319	576,299
Federal funds purchased	-	13,190
Federal Home Loan Bank advances and other borrowings	124,100	124,100
Junior subordinated debentures	13,403	13,403
Other liabilities	7,344	6,881
Total liabilities	825,166	733,873
SHAREHOLDERS EQUITY		
Preferred stock, par value $.01 per share, 10,000,000 shares authorized, 15,299 and 16,299 shares issued and outstanding at December 31, 2013 and 2012, respectively	15,299	16,299
Common stock, par value $.01 per share, 10,000,000 shares authorized, 4,319,750 and 4,247,404 shares issued and outstanding at December 31, 2013 and 2012, respectively	43	43
Nonvested restricted stock	(636)	(160)
Additional paid-in capital	43,585	42,396
Accumulated other comprehensive income (loss)	(1,348)	1,178
Retained earnings	8,722	4,369
Total shareholders equity	65,665	64,125
Total liabilities and shareholders equity	$890,831	797,998

See notes to consolidated financial statements that are an integral part of these consolidated statements. Paid in capital, retained earnings and common shares outstanding have been adjusted to reflect the 10 percent stock dividends in 2013 and 2012.

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

	For the years ended December 31,		
(dollars in thousands, except per share data)	**2013**	**2012**	**2011**
Interest income			
Loans	$34,242	32,668	32,892
Investment securities	1,813	1,963	2,144
Federal funds sold	63	67	106
Total interest income	36,118	34,698	35,142
Interest expense			
Deposits	2,862	4,177	6,993
Borrowings	4,235	4,525	4,861
Total interest expense	7,097	8,702	11,854
Net interest income	29,021	25,996	23,288
Provision for loan losses	3,475	4,550	5,270
Net interest income after provision for loan losses	25,546	21,446	18,018
Noninterest income			
Loan fee income	1,235	1,044	877
Service fees on deposit accounts	879	767	638
Income from bank owned life insurance	658	632	565
Gain on sale of investment securities	-	363	23
Other than temporary impairment on investment	-	-	(25)

securities			
Other income	1,030	956	692
Total noninterest income	3,802	3,762	2,770
Noninterest expenses			
Compensation and benefits	12,302	10,073	8,933
Occupancy	3,056	2,468	2,282
Real estate owned activity	179	939	940
Data processing and related costs	2,406	2,070	1,869
Insurance	818	1,367	1,437
Marketing	731	637	686
Professional fees	858	841	658
Other	1,462	1,118	1,062
Total noninterest expenses	21,812	19,513	17,867
Income before income tax expense	7,536	5,695	2,921
Income tax expense	2,416	1,833	833
Net income	5,120	3,862	2,088
Preferred stock dividend	771	840	865
Discount accretion	-	360	279
Redemption of preferred stock	(20)	(96)	-
Net income available to common shareholders	$4,369	2,758	944
Earnings per common share			
Basic	$1.02	0.65	0.22
Diluted	$0.98	0.64	0.22
Weighted average common shares outstanding			
Basic	4,279,992	4,229,928	4,200,980
Diluted	4,458,918	4,339,958	4,286,418

See notes to consolidated financial statements that are an integral part of these consolidated statements. Earnings per share and common shares outstanding have been adjusted to reflect the 10 percent stock dividends in 2013, 2012 and 2011.

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

	For the years ended December 31,		
(dollars in thousands)	**2013**	**2012**	**2011**
Net income	$5,120	3,862	2,088
Other comprehensive income:			
Unrealized gain (loss) on securities available for sale:			
Unrealized holding gain (loss) arising during the period, pretax	(3,829)	573	2,633
Tax (expense) benefit	1,303	(195)	(895)
Reclassification of realized gain	-	(363)	(23)
Tax expense	-	122	8
Other-than-temporary impairment	-	-	25
Other comprehensive income (loss)	(2,526)	137	1,748
Comprehensive income	$2,594	3,999	3,836

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

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SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2013, 2012 AND 2011

	Common stock		**Preferred stock**		**Nonvested restricted**	**Additional paid-in**	**Acc oth com inc**
(dollars in thousands, except share data)	**Shares**	**Amount**	**Shares**	**Amount**	**stock**	**capital**	**(los**
December 31, 2010	3,457,877	$35	17,299	$16,317	$-	$36,729	$(7
Net income	-	-	-	-	-	-	-
Preferred stock transactions:							
Cash dividends on Series T preferred stock	-	-	-	-	-	-	-
Discount accretion	-	-	-	279	-	-	-
Proceeds from exercise of stock warrants	13,236	-	-	-	-	77	-
Stock dividend on common stock (10%)	347,217	3	-	-	-	2,448	-
Cash in lieu of fractional shares	-	-	-	-	-	-	-
Issuance of restricted stock	2,500	-	-	-	(20)	20	-
Amortization of deferred compensation on restricted stock	-	-	-	-	4	-	-
Compensation expense related to stock options, net of tax	-	-	-	-	-	272	-
Other comprehensive income	-	-	-	-	-	-	1,7
December 31, 2011	3,820,830	38	17,299	16,596	(16)	39,546	1,0
Net income	-	-	-	-	-	-	-
Preferred stock transactions:							
Redemption of preferred stock	-	-	(1,000)	(1,000)	-	-	-
Redemption of CPP Warrant	-	-	-	-	-	(1,100)	-
Cash dividends on Series T preferred stock	-	-	-	-	-	-	-
Discount accretion	-	-	-	703	-	(343)	-
Proceeds from exercise of stock options	15,336	1	-	-	-	95	-
Stock dividend on common stock (10%)	388,738	4	-	-	-	3,712	-
Cash in lieu of fractional shares	-	-	-	-	-	-	-
Issuance of restricted stock	22,500	-	-	-	(175)	175	-
Amortization of deferred compensation on restricted stock	-	-	-	-	31	-	-
Compensation expense related to stock options, net of tax	-	-	-	-	-	311	-
Other comprehensive income	-	-	-	-	-	-	137
December 31, 2012	**4,247,404**	**43**	**16,299**	**16,299**	**(160)**	**42,396**	**1,1**
Net income	-	-	-	-	-	-	-
Preferred stock transactions:							
Redemption of preferred stock	-	-	(1,000)	(1,000)	-	-	-
Cash dividends on Series T preferred stock	-	-	-	-	-	-	-

Proceeds from exercise of stock options	28,596	-	-	-	-	198	-
Cash in lieu of fractional shares	-	-	-	-	-	-	-
Issuance of restricted stock	43,750	-	-	-	(564)	564	-
Amortization of deferred compensation on restricted stock	-	-	-	-	88	-	-
Compensation expense related to stock options, net of tax	-	-	-	-	-	427	-
Other comprehensive income (loss)	-	-	-	-	-	-	(2,
December 31, 2013	**4,319,750**	**$43**	**15,299**	**$15,299**	**$(636)**	**$43,585**	**$(1**

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

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

	For the years ended December 31,		
(dollars in thousands)	**2013**	**2012**	**2011**
Operating activities			
Net income	$5,120	3,862	2,088
Adjustments to reconcile net income to cash provided by operating activities:			
Provision for loan losses	3,475	4,550	5,270
Depreciation and other amortization	1,205	979	884
Accretion and amortization of securities discounts and premiums, net	659	850	1,066
Loss on sale of real estate owned	5	458	318
	130	419	782

Write-down of real estate owned			
Gain on sale of real estate held for investment	-	-	(150)
Gain on sale of investment securities:			
Available for sale	-	(363)	(23)
Other-than-temporary impairment on investment securities	-	-	25
Loss on sale of property and equipment	-	-	27
Compensation expense related to stock options and restricted stock grants	515	342	276
Increase in cash surrender value of bank owned life insurance	(658)	(632)	(565)
Increase in deferred tax asset	(460)	(297)	(853)
Decrease (increase) in other assets, net	(314)	1,017	729
Increase in other liabilities, net	463	690	1,316
Net cash provided by operating activities	10,140	11,875	11,190
Investing activities			
Increase (decrease) in cash realized from:			
Increase in loans, net	(95,025)	(53,279)	(31,878)
Purchase of property and equipment	(2,299)	(2,370)	(2,369)
Purchase of investment securities:			
Available for sale	(3,260)	(35,014)	(81,591)
Other investments	(2,025)	-	-
Payment and maturity of investment securities:			
Available for sale	9,555	12,031	14,374
Other investments	2,218	130	1,146
Proceeds from sale of investment securities:			
Available for sale	-	45,143	31,914
Other investments	1,485	-	-
	(2,000)	-	(3,000)

Purchase of life insurance policies			
Proceeds from sale of property held for investment	-	-	1,793
Proceeds from sale of other real estate owned	1,740	2,670	1,749
Net cash used for investing activities	(89,611)	(30,689)	(67,862)
Financing activities			
Increase (decrease) in cash realized from:			
Increase in deposits, net	104,020	13,387	26,616
Increase in note payable	-	1,400	-
Increase (decrease) in Federal Home Loan Bank advances and other borrowings	(13,190)	13,190	-
Redemption of preferred stock	(980)	(1,100)	-
Redemption of CPP warrant	-	(904)	-
Cash dividend on preferred stock	(778)	(845)	(865)
Cash in lieu of fractional shares	(9)	(2)	(1)
Proceeds from the exercise of stock options and warrants	198	96	77
Net cash provided by financing activities	89,261	25,222	25,827
Net increase (decrease) in cash and cash equivalents	9,790	6,408	(30,845)
Cash and cash equivalents, beginning of year	29,413	23,005	53,850
Cash and cash equivalents, end of year	$39,203	29,413	23,005
Supplemental information			
Cash paid for			
Interest	$7,571	8,669	11,897
Income taxes	2,876	2,129	1,685
Schedule of non-cash transactions			
Foreclosure of real estate	1,354	1,580	907
Unrealized (gain) loss on securities, net of income	2,526	(378)	(1,738)

taxes

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

NOTE 1 Summary of Significant Accounting Policies and Activities

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

Basis of Presentation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Southern First Bank. We have no additional reportable operating segments under Accounting Standards Codification (ASC) 280 Segment Reporting. In consolidation, all significant intercompany transactions have been eliminated. The accounting and reporting policies conform to accounting principles generally accepted in the United States of America. In accordance with guidance issued by the Financial Accounting Standards Board (FASB), the operations of the Trusts have not been consolidated in these financial statements.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of income and expenses during the reporting periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near

term relate to the determination of the allowance for loan losses, real estate acquired in settlement of loans, fair value of financial instruments, evaluating other-than-temporary-impairment of investment securities and valuation of deferred tax assets.

Risks and Uncertainties

In the normal course of its business, the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different bases, than its interest-earning assets. Credit risk is the risk of default within the Company s loan portfolio that results from borrowers inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to changes with respect to valuation of assets, amount of required loan loss allowance and operating restrictions resulting from the regulators judgments based on information available to them at the time of their examinations.

The Bank makes loans to individuals and businesses in the Upstate, Midlands, and Lowcountry regions of South Carolina for various personal and commercial purposes. The Bank s loan portfolio has a concentration of real estate loans. As of December 31, 2013 and 2012, real estate loans represented 80.6% and 80.9%, respectively, of total loans. However, borrowers ability to repay their loans is not dependent upon any specific economic sector.

Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

On January 27, 2014, the Company issued a total of 475,000 shares of its common stock to two controlled affiliates of EJF Capital, Inc. (collectively, EJF) at $13.00 per share in a private placement pursuant to Regulation D (the Private Placement). The gross proceeds to the Company from the Private Placement were used by the Company to redeem

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4,057 shares of outstanding Series T Preferred Stock at a redemption price of $1,000 per share, or $4.1 million. The redemption of the 4,057 shares of Series T Preferred Stock will reduce the Company s annual preferred dividend expenses by approximately $200,000.

The following table is a pro-forma statement to include the Private Placement and the Series T Preferred Stock redemption as of December 31, 2013.

			As of December 31, 2013	
		Common stock	**Preferred stock**	
(Dollars in thousands)	**Reported**	**Issuance, Net**	**Redemption**	**Pro Forma**
Common equity	$50,366	$5,940	-	$56,306
Preferred equity	$15,299		($4,057)	$11,242
Total shareholders' equity	$65,665	$5,940	($4,057)	$67,548
Common Shares	4,319,750	475,000	-	4,794,750
Book value per common share	$11.66			$11.74
Tangible common equity/tangible asset ratio	5.65%			6.32%
Tier I common ratio	7.09%			7.90%
Tier I leverage ratio	9.13%			9.35%
Tier I risk-based ratio	10.96%			11.22%
Total risk-based ratio	12.22%			12.47%

Reclassifications

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

Cash and Cash Equivalents

Cash and cash equivalents include cash and due from banks, interest bearing deposits and federal funds sold. Cash and cash equivalents have original maturities of three months or less, and federal funds sold are generally purchased and sold for one-day periods. Accordingly, the carrying value of these instruments is deemed to be a reasonable estimate of fair value. At December 31, 2013 and 2012, included in cash and cash equivalents was $16.9 million and $15.6 million, respectively, on deposit to meet Federal Reserve Bank requirements.

Investment Securities

We classify our investment securities as held to maturity securities, trading securities and available for sale securities as applicable.

Debt securities are designated as held to maturity if we have the intent and the ability to hold the securities to maturity. Held to maturity securities are carried at amortized cost, adjusted for the amortization of any related premiums or the accretion of any related discounts into interest income using a methodology which approximates a level yield of interest over the estimated remaining period until maturity. Unrealized losses on held to maturity securities, reflecting a decline in value judged by us to be other than temporary, are charged to income in the Consolidated Statements of Income.

Debt and equity securities that are purchased and held principally for the purpose of selling in the near term are reported as trading securities. Trading securities are carried at fair value with unrealized holding gains and losses included in earnings.

We classify debt and equity securities as available for sale when at the time of purchase we determine that such securities may be sold at a future date or if we do not have the intent or ability to hold such securities to maturity. Securities designated as available for sale are recorded at fair value. Changes in the fair value of debt and equity securities available for sale are included in shareholders equity as unrealized gains or losses, net of the related tax effect. Unrealized losses on available for sale securities, reflecting a decline in value judged to be other than temporary, are charged to income in the Consolidated Statements of Income. Realized gains or losses on available for sale securities are computed on the specific identification basis.

Other Investments

The Bank, as a member institution, is required to own a stock investment in the Federal Home Loan Bank of Atlanta (FHLB). Cash dividends on our FHLB stock are recorded in investment income. Prior to the Bank s conversion to a state charter on April 1, 2013, the Bank was also required to own stock in the Federal Reserve Bank. These stocks are generally pledged against any borrowings from these institutions. No ready market exists for these stocks and they have no quoted market value. However, redemption of these stocks has historically been at par value. Other investments also include a $403,000 investment in the Trusts.

Loans

Loans are stated at the principal balance outstanding. Unamortized net loan fees and the allowance for possible loan losses are deducted from total loans on the balance sheets. Interest income is recognized over the term of the loan based on the principal amount outstanding. The net of loan origination fees received and direct costs incurred in the origination of loans is deferred and amortized to interest income over the contractual life of the loans adjusted for actual principal prepayments using a method approximating the interest method.

Nonaccrual and Past Due Loans

Loans are generally placed on nonaccrual status when principal or interest becomes 90 days past due, or when payment in full is not anticipated. When a loan is placed on nonaccrual status, interest accrued but not received is generally reversed against interest income. Cash receipts on nonaccrual loans are not recorded as interest income, but are used to reduce the loan s principal balance. A nonaccrual loan is generally returned to accrual status and accrual of interest is resumed when payments have been made according to the terms and conditions of the loan for a continuous six month period. Our loans are considered past due when contractually required principal or interest payments have not been made on the due dates.

Nonperforming Assets

Nonperforming assets include real estate acquired through foreclosure or deed taken in lieu of foreclosure, loans on nonaccrual status and loans past due 90 days or more and still accruing interest. Loans are placed on nonaccrual status when, in the opinion of management, the collection of additional interest is uncertain. Thereafter no interest is taken into income until such time as the borrower demonstrates the ability to pay both principal and interest.

Impaired Loans

Our impaired loans include loans on nonaccrual status and loans modified in a troubled debt restructuring (TDR), whether on accrual or nonaccrual status. For loans that are classified as impaired, an allowance is established when the fair value (discounted cash flows, collateral value, or observable market price) of the impaired loan less costs to sell, are lower than the carrying value of that loan. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due, among other factors. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including, without limitation, the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. In the first quarter of 2013, we began to evaluate impaired consumer loans on a loan by loan basis, using the same criteria as those used to evaluate impaired commercial loans. Prior to this change, large groups of smaller balance homogeneous consumer loans were collectively evaluated for impairment, and we did not separately identify individual consumer loans for impairment disclosures.

Loan Charge-off Policy

For commercial loans, we generally fully charge off or charge collateralized loans down to net realizable value when management determines the loan to be uncollectible; repayment is deemed to be projected beyond reasonable time

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frames; the loan has been classified as a loss by either our internal loan review process or our banking regulatory agencies; the client has filed bankruptcy and the loss becomes evident owing to a lack of assets; or the loan is 120 days past due unless both well-secured and in the process of collection. For consumer loans, we generally charge down to net realizable value when the loan is 180 days past due.

Troubled Debt Restructuring (TDRs)

The Company considers a loan to be a TDR when the debtor experiences financial difficulties and the Company provides concessions such that we will not collect all principal and interest in accordance with the original terms of the loan agreement. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of our workout plan for individual loan relationships, we may restructure loan terms to assist borrowers facing challenges in the current economic environment.

Our policy with respect to accrual of interest on loans restructured in a TDR follows relevant supervisory guidance. That is, if a borrower has demonstrated performance under the previous loan terms and shows capacity to perform under the restructured loan terms; continued accrual of interest at the restructured interest rate is likely. If a borrower was materially delinquent on payments prior to the restructuring, but shows capacity to meet the restructured loan terms, the loan will likely continue as nonaccrual going forward. Lastly, if the borrower does not perform under the restructured terms, the loan is placed on nonaccrual status. We will continue to closely monitor these loans and will cease accruing interest on them if management believes that the borrowers may not continue performing based on the restructured note terms. If, after previously being classified as a TDR, a loan is restructured a second time, then that loan is automatically placed on nonaccrual status. Our policy with respect to nonperforming loans requires the borrower to make a minimum of six consecutive payments of principal and interest in accordance with the loan terms before that loan can be placed back on accrual status. Further, the borrower must show capacity to continue performing into the future prior to restoration of accrual status.

As a result of adopting the amendments in Accounting Standards Update (ASU) 2011-02, we reassessed all restructurings that occurred on or after the beginning of the fiscal year of adoption (January 1, 2011) to determine whether they are considered TDRs under the amended guidance. The amendments in ASU 2011-02 require prospective application of the impairment measurement guidance in ASC 310-10-35 for those loans newly identified as impaired. In the determination of the allowance for loan losses, management considers TDRs on commercial and consumer loans and subsequent defaults in these restructurings by measuring impairment, on a loan by loan basis, based on either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral, less costs to sell, if the loan is collateral dependent.

Allowance for Loan Losses

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

We have an established process to determine the adequacy of the allowance for loan losses that assesses the losses inherent in our portfolio. While we attribute portions of the allowance to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. Our process involves procedures to appropriately consider the unique risk characteristics of our commercial and consumer loan portfolio segments. For each portfolio segment, impairment is measured individually for each impaired loan. Our allowance levels are influenced by loan volume, loan grade or delinquency status, historic loss experience and other economic conditions. See Note 3 to the Consolidated Financial Statements for additional information on the Allowance for Loan Losses.

Other Real Estate Owned

Real estate acquired through foreclosure is initially recorded at the lower of cost or estimated fair value. Subsequent to the date of acquisition, it is carried at the lower of cost or fair value, adjusted for net selling costs. Fair values of real

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estate owned are reviewed regularly and writedowns are recorded when it is determined that the carrying value of real estate exceeds the fair value less estimated costs to sell. Costs relating to the development and improvement of such property are capitalized, whereas those costs relating to holding the property are expensed.

Property and Equipment

Property and equipment are stated at cost. Major repairs are charged to operations, while major improvements are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Upon retirement, sale, or other disposition of property and equipment, the cost and accumulated depreciation are eliminated from the accounts, and gain or loss is included in income from operations.

Construction in progress is stated at cost, which includes the cost of construction and other direct costs attributable to the construction. No provision for depreciation is made on construction in progress until such time as the relevant assets are completed and put into use.

Bank Owned Life Insurance Policies

Bank owned life insurance policies represent the cash value of policies on certain officers of the Company.

Securities Sold Under Agreements to Repurchase

The Bank enters into sales of securities under agreements to repurchase (reverse repurchase agreements). Repurchase agreements are treated as financing, with the obligation to repurchase securities sold being reflected as a liability and the securities underlying the agreements remaining as assets in the Consolidated Balance Sheets.

Comprehensive Income

Comprehensive income (loss) consists of net income and net unrealized gains (losses) on securities and is presented in the statements of shareholders equity and comprehensive income. The statement requires only additional disclosures in the consolidated financial statements; it does not affect our results of operations.

Income Taxes

The financial statements have been prepared on the accrual basis. When income and expenses are recognized in different periods for financial reporting purposes versus for the purposes of computing income taxes currently payable, deferred taxes are provided on such temporary differences. Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the consolidated financial statements or tax returns. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. The Company believes that its income tax filing positions taken or expected to be taken on its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company s financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded. The Company s federal and state income tax returns are open and subject to examination from the 2010 tax return year and forward.

Stock-Based Compensation

The Company has a stock-based employee compensation plan. Compensation cost is recognized for all stock options granted and for any outstanding unvested awards as if the fair value method had been applied to those awards as of the date of grant.

Recently Adopted Accounting Pronouncements

The following is a summary of recent authoritative pronouncements that impacted the accounting, reporting, and/or disclosure of financial information by the Company.

The Comprehensive Income topic of the ASC was amended in June 2011. The amendment eliminated the option to present other comprehensive income as a part of the statement of changes in stockholders equity and required consecutive presentation of the statement of net income and other comprehensive income. The amendments were

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applicable to the Company January 1, 2012 and have been applied retrospectively. In December 2011, the topic was further amended to defer the effective date of presenting reclassification adjustments from other comprehensive income to net income on the face of the financial statements while the FASB redeliberated the presentation requirements for the reclassification adjustments. In February 2013, the FASB further amended the Comprehensive Income topic clarifying the conclusions from such redeliberations. Specifically, the amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments do require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, in certain circumstances an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amendments were effective for the Company on a prospective basis for reporting periods beginning after December 15, 2012. These amendments did not have a material effect on the Company s financial statements.

NOTE 2 Investment Securities

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

	December 31, 2013			
	Amortized	**Gross Unrealized**		**Fair**
(dollars in thousands)	**Cost**	**Gains**	**Losses**	**Value**
Available for sale				
US government agencies	$8,756	-	1,001	7,755
SBA securities	5,758	-	487	5,271
State and political subdivisions	23,622	331	583	23,370
Mortgage-backed securities				
FHLMC	7,596	62	186	7,472
FNMA	23,603	172	363	23,412
GNMA	148	12	-	160
Total mortgage-backed securities	31,347	246	549	31,044
Total	$69,483	577	2,620	67,440

	December 31, 2012			
	Amortized	**Gross Unrealized**		**Fair**
	Cost	**Gains**	**Losses**	**Value**
Available for sale				
US government agencies	$7,781	14	10	7,785
SBA securities	6,060	17	5	6,072
State and political subdivisions	24,167	1,130	48	25,249
Mortgage-backed securities				
FHLMC	8,434	196	-	8,630
FNMA	29,718	484	14	30,188
GNMA	276	22	-	298
Total mortgage-backed securities	38,428	702	14	39,116
Total	$76,436	1,863	77	78,222

During 2012, we developed a need for additional liquidity as we experienced increased loan demand and, as a result, sold $45.1 million of our mortgage-backed securities and state and municipal obligations, reinvested $18.1 million of the securities in similar investments at current rates, and recorded a net gain on sale of investment securities of $363,000. There were no sales of investment securities during 2013.

The amortized costs and fair values of investment securities available for sale at December 31, 2013 and 2012, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because issuers have the right to prepay the obligations.

(dollars in thousands)	2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
Due within one year	$1,507	1,507	417	421
Due after one through five years	2,121	2,114	3,690	3,671
Due after five through ten years	10,268	10,426	4,612	5,031
Due after ten years	55,587	53,393	67,717	69,099
	$69,483	67,440	76,436	78,222

The tables below summarize gross unrealized losses on investment securities and the fair market value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2013 and 2012.

(dollars in thousands)	Less than 12 months			12 months or longer			Total		
	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses
As of December 31, 2013									
Available for sale									
US government agencies	3	$7,755	$1,001	-	$-	$-	3	$7,755	$1,001
SBA securities	-	-	-	2	5,271	487	2	5,271	487
State and political subdivisions	22	8,482	364	9	3,705	219	31	12,187	583
Mortgage-backed									
FHLMC	3	5,006	186	-	-	-	3	5,006	186
FNMA	7	11,140	363	-	-	-	7	11,140	363

	35	$32,383	$1,914	11	$8,976	$706	46	$41,359	$2,620
As of December 31, 2012									
Available for sale									
US government agencies	1	$3,771	$10	-	$-	$-	1	$3,771	$10
SBA securities	1	2,015	5	-	-	-	1	2,015	5
State and political subdivisions	16	6,608	48	-	-	-	16	6,608	48
Mortgage-backed									
FHLMC	-	-	-	-	-	-	-	-	-
FNMA	2	3,669	14	-	-	-	2	3,669	14
	20	$16,063	$77	-	$-	$-	20	$16,063	$77

At December 31, 2013, the Company had 35 individual investments with a fair market value of $32.4 million that were in an unrealized loss position for less than 12 months and 11 individual investments with a fair market value of $9.0 million that were in an unrealized loss position for 12 months or longer. The unrealized losses were primarily attributable to changes in interest rates, rather than deterioration in credit quality. The individual securities are each investment grade securities. The Company considers the length of time and extent to which the fair value of available-for-sale debt securities have been less than cost to conclude that such securities were not other-than-temporarily impaired. We also consider other factors such as the financial condition of the issuer including credit ratings and specific events affecting the operations of the issuer, volatility of the security, underlying assets that collateralize the debt security, and other industry and macroeconomic conditions. As the Company has no intent to sell securities with unrealized losses and it is not more-likely-than-not that the Company will be required to sell these securities before recovery of amortized cost, we have concluded that the securities are not impaired on an other-than-temporary basis.

During the second quarter of 2011, the Company recorded a $25,000 other-than-temporary impairment (OTTI) charge to earnings on its one private-label collateralized mortgage obligation ("CMO") which had been in an unrealized loss position for over 12 months. During the third quarter of 2011, the Company sold the $2.5 million CMO as part of an

investment portfolio restructuring and recognized an additional loss of $512,000 on the security. In addition to the CMO, the Company sold $26.9 million of securities during the second half of 2011, recognizing a gain on sale of $535,000.

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

	December 31,	
(dollars in thousands)	**2013**	**2012**
Federal Reserve Bank stock	$-	1,485
Federal Home Loan Bank stock	5,614	5,807
Certificates of deposit	99	99
Investment in Trust Preferred subsidiaries	403	403
	$6,116	7,794

The Company has evaluated the FHLB stock for impairment and determined that the investment in FHLB stock is not other than temporarily impaired as of December 31, 2013 and ultimate recoverability of the par value of this investment is probable. All of the FHLB stock is used to collateralize advances with the FHLB.

At December 31, 2013, $22.0 million of securities were pledged as collateral for repurchase agreements from brokers, and approximately $25.0 million was pledged to secure client deposits. At December 31, 2012, $22.8 million of securities were pledged as collateral for repurchase agreements from brokers. In addition, approximately $10.5 million was pledged to secure client deposits.

NOTE 3 Loans and Allowance for Loan Losses

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily in the Upstate, Midlands, and Low Country regions of South Carolina. The Company s loan portfolio is not concentrated in loans to any single borrower or a relatively small number of borrowers. The Company focuses its lending activities primarily on the professional markets in Greenville, Columbia, and Charleston including doctors, dentists, and small business owners. The principal component of the loan portfolio is loans secured by real estate mortgages which account for 80.6% of total loans at December 31, 2013. Commercial loans comprise 64.3% of total real estate loans and consumer loans account for 35.7%. Commercial loans are further categorized into owner occupied which represents 25.1% of total loans and non-owner occupied loans represent 22.5%. Commercial construction loans represent only 4.2% of the total loan portfolio.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risk from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc.), and loans with high loan-to-value ratios. As of December 31, 2013, approximately $84.1 million, or 11.4% of our loans had loan-to-value ratios which exceeded regulatory supervisory limits, of which 78 loans totaling approximately $32.7 million had loan-to-value ratios of 100% or more. Additionally,

there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan s life. For example, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e. balloon payment loans). The various types of loans are individually underwritten and monitored to manage the associated risks.

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

Portfolio Segment Methodology

Commercial

Commercial loans are assessed for estimated losses by grading each loan using various risk factors identified through periodic reviews. We apply historic grade-specific loss factors to each class of loan. In the development of our

statistically derived loan grade loss factors, we observe historical losses over 12 quarters for each loan grade. These loss estimates are adjusted as appropriate based on additional analysis of external loss data or other risks identified from current economic conditions and credit quality trends. The allowance also includes an amount for the estimated impairment on nonaccrual commercial loans and commercial loans modified in a TDR, whether on accrual or nonaccrual status.

Consumer

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

The following table summarizes the composition of our loan portfolio. Total gross loans are recorded net of deferred loan fees and costs, which totaled $1.3 million as of December 31, 2013 and December 31, 2012, respectively.

	December 31,	
(dollars in thousands)	**2013**	**2012**
Commercial		
Owner occupied	$185,129	158,790
Non-owner occupied	166,016	165,163
Construction	30,906	20,347
Business	129,687	114,169
Total commercial loans	511,738	458,469
Consumer		
Residential	114,201	86,559
Home equity	78,479	77,895
Construction	19,888	13,749
Other	12,961	9,277
Total consumer loans	225,529	187,480
Total gross loans, net of deferred fees	737,267	645,949
Less allowance for loan losses	(10,213)	(9,091)
Total loans, net	$727,054	636,858

The composition of gross loans by rate type is as follows:

	December 31,	
(dollars in thousands)	**2013**	**2012**
Variable rate loans	$224,866	219,462
Fixed rate loans	512,401	426,487
	$737,267	645,949

At December 31, 2013, approximately $173.4 million of the Company s mortgage loans were pledged as collateral for advances from the FHLB, as set forth in Note 8.

Credit Quality Indicators

Commercial

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

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

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

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

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

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

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

				December 31, 2013	
	Owner	**Non-owner**			
(dollars in thousands)	**occupied RE**	**occupied RE**	**Construction**	**Business**	**Total**
Current	$183,609	161,758	29,992	128,883	504,242
30-59 days past due	791	859	-	44	1,694
60-89 days past due	-	-	-	-	-
Greater than 90 days	729	3,399	914	760	5,802
	$185,129	166,016	30,906	129,687	511,738

				December 31, 2012	
	Owner	**Non-owner**			
	occupied RE	**occupied RE**	**Construction**	**Business**	**Total**
Current	$157,036	163,700	19,341	112,322	452,399
30-59 days past due	306	-	-	539	845
60-89 days past due	-	463	-	100	563
Greater than 90 days	1,448	1,000	1,006	1,208	4,662
	$158,790	165,163	20,347	114,169	458,469

As of December 31, 2013 and 2012, loans 30 days or more past due represented 1.29% and 1.11% of our total loan portfolio, respectively. Commercial loans 30 days or more past due were 1.02% and 0.94% as of December 31, 2013 and 2012, respectively.

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

				December 31, 2013	
	Owner	**Non-owner**			
(dollars in thousands)	**occupied RE**	**occupied RE**	**Construction**	**Business**	**Total**

Pass	$176,320	147,378	27,797	120,254	471,749
Special Mention	5,563	7,987	-	3,629	17,179
Substandard	3,246	10,651	3,109	5,804	22,810
Doubtful	-	-	-	-	-
	$185,129	166,016	30,906	129,687	511,738

				December 31, 2012	
	Owner occupied RE	**Non-owner occupied RE**	**Construction**	**Business**	**Total**
Pass	$148,255	141,352	18,265	105,024	412,896
Special Mention	7,446	9,358	-	2,750	19,554
Substandard	3,089	14,453	2,082	6,395	26,019
Doubtful	-	-	-	-	-
	$158,790	165,163	20,347	114,169	458,469

Consumer

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

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

				December 31, 2013	
(dollars in thousands)	**Real estate**	**Home equity**	**Construction**	**Other**	**Total**
Current	$112,314	78,402	19,888	12,877	223,481
30-59 days past due	806	-	-	84	890
60-89 days past due	467	-	-	-	467
Greater than 90 days	614	77	-	-	691

	Real estate	Home equity	Construction	Other	Total
	$114,201	78,479	19,888	12,961	225,529

				December 31, 2012	
	Real estate	Home equity	Construction	Other	Total
Current	$85,999	77,430	13,749	9,233	186,411
30-59 days past due	560	100	-	-	660
60-89 days past due	-	-	-	44	44
Greater than 90 days	-	365	-	-	365
	$86,559	77,895	13,749	9,277	187,480

Consumer loans 30 days or more past due were 0.28% and 0.17% as of December 31, 2013 and 2012, respectively.

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

				December 31, 2013	
(dollars in thousands)	Real estate	Home equity	Construction	Other	Total
Pass	$110,304	75,304	19,888	12,641	218,137
Special Mention	1,455	2,176	-	212	3,843
Substandard	2,442	999	-	108	3,549
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
	$114,201	78,479	19,888	12,961	225,529

				December 31, 2012	
	Real estate	Home equity	Construction	Other	Total
Pass	$83,173	73,718	13,749	8,752	179,392
Special Mention	2,307	2,290	-	170	4,767
Substandard	1,079	1,887	-	355	3,321
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
	$86,559	77,895	13,749	9,277	187,480

Nonperforming assets

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

payment of interest on a loan that is classified as nonaccrual is recognized as a reduction in principal when received.

(dollars in thousands)	December 31, 2013	2012
Commercial		
Owner occupied RE	$1,199	155
Non-owner occupied RE	373	1,255
Construction	914	1,006
Business	712	202
Consumer		
Real estate	76	119
Home equity	77	577
Construction	-	-
Other	3	44
Nonaccruing troubled debt restructurings	4,983	4,809
Total nonaccrual loans, including nonaccruing TDRs	8,337	8,167
Other real estate owned	1,198	1,719
Total nonperforming assets	$9,535	9,886
Nonperforming assets as a percentage of:		
Total assets	1.07%	1.24%
Gross loans	1.29%	1.53%
Total loans over 90 days past due	$6,493	5,027
Loans over 90 days past due and still accruing	-	-
Accruing TDRs	8,045	9,421

Foregone interest income on the nonaccrual loans for the year ended December 31, 2013 was approximately $543,000 and approximately $402,000 for the same period in 2012.

Impaired Loans

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

	December 31, 2013			
	Recorded investment			
(dollars in thousands)	Unpaid Principal Balance	Impaired loans	Impaired loans with related allowance for loan losses	Related allowance for loan losses
Commercial				
Owner occupied RE	$1,935	1,935	1,666	333
Non-owner occupied RE	5,957	5,622	6,125	1,441
Construction	4,612	1,870	1,855	246
Business	5,494	4,684	2,807	1,813
Total commercial	17,998	14,111	12,453	3,833
Consumer				
Real estate	1,829	1,807	1,447	704
Home equity	239	239	239	188
Construction	-	-	-	-
Other	225	225	4	4
Total consumer	2,293	2,271	1,690	896
Total	$20,291	16,382	14,143	4,729

December 31, 2012

Recorded investment

Impaired loans

	Unpaid Principal Balance	Impaired loans	with related allowance for loan losses	Related allowance for loan losses
Commercial				
Owner occupied RE	$3,071	2,271	2,116	398
Non-owner occupied RE	7,497	7,162	2,218	831
Construction	4,824	2,082	1,075	213
Business	4,048	4,048	3,329	2,092
Total commercial	19,440	15,563	8,738	3,534
Consumer				
Real estate	985	985	162	24
Home equity	770	770	605	91
Construction	-	-	-	-
Other	270	270	-	-
Total consumer	2,025	2,025	767	115
Total	$21,465	17,588	9,505	3,649

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

	Year ended December 31,					
	2013		2012		2011	
(dollars in thousands)	Average recorded investment	Recognized interest income	Average recorded investment	Recognized interest income	Average recorded investment	Recognized interest income
Commercial						
Owner occupied RE	$1,519	47	3,881	17	3,521	220
Non-owner occupied RE	5,932	261	5,811	392	2,520	281
Construction	2,054	57	2,127	66	1,425	81
Business	4,521	189	3,880	84	3,331	207
Total commercial	14,026	554	15,699	559	10,797	789
Consumer						
Real estate	1,186	100	1,397	44	1,729	64
Home equity	610	8	518	12	399	-
Construction	-	-	-	-	-	-
Other	234	9	240	14	38	13
Total consumer	2,030	117	2,155	70	2,166	77

Total	$16,056	671	17,854	629	12,963	866

Allowance for Loan Losses

The following table summarizes the activity related to our allowance for loan losses:

	Year ended December 31,		
(dollars in thousands)	**2013**	**2012**	**2011**
Balance, beginning of period	$9,091	8,925	8,386
Provision for loan losses	3,475	4,550	5,270
Loan charge-offs:			
Commercial			
Owner occupied RE	(390)	(1,857)	(72)
Non-owner occupied RE	(249)	(513)	(1,052)
Construction	-	-	(67)
Business	(1,664)	(1,230)	(3,243)
Total commercial	(2,303)	(3,600)	(4,434)
Consumer			
Real estate	(22)	(214)	(129)
Home equity	(106)	(691)	(175)
Construction	-	-	-
Other	(47)	-	(200)
Total consumer	(175)	(905)	(504)
Total loan charge-offs	(2,478)	(4,505)	(4,938)
Loan recoveries:			
Commercial			
Owner occupied RE	1	4	14
Non-owner occupied RE	1	42	42
Construction	-	-	-

Business	115	27	149
Total commercial	117	73	205
Consumer			
Real estate	-	2	-
Home equity	8	32	2
Construction	-	-	-
Other	-	14	-
Total consumer	8	48	2
Total recoveries	125	121	207
Net loan charge-offs	(2,353)	(4,384)	(4,731)
Balance, end of period	$10,213	9,091	8,925

The following tables summarize the activity in the allowance for loan losses by our commercial and consumer portfolio segments.

	Year ended December 31, 2013			
(dollars in thousands)	**Commercial**	**Consumer**	**Unallocated**	**Total**
Balance, beginning of period	$7,981	1,110	-	9,091
Provision	2,444	1,031	-	3,475
Loan charge-offs	(2,303)	(175)	-	(2,478)
Loan recoveries	117	8	-	125
Net loan charge-offs	(2,186)	(167)	-	(2,353)
Balance, end of period	$8,239	1,974	-	10,213

	Year ended December 31, 2012			
	Commercial	**Consumer**	**Unallocated**	**Total**
Balance, beginning of period	$8,061	864	-	8,925
Provision	3,447	1,103	-	4,550
Loan charge-offs	(3,600)	(905)	-	(4,505)
Loan recoveries	73	48	-	121
Net loan charge-offs	(3,527)	(857)	-	(4,384)
Balance, end of period	$7,981	1,110	-	9,091

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

				December 31, 2013		
	Allowance for loan losses			Recorded investment in loans		
(dollars in thousands)	**Commercial**	**Consumer**	**Total**	**Commercial**	**Consumer**	**Total**
Individually evaluated	$3,833	896	4,729	14,111	2,271	16,382
Collectively evaluated	4,406	1,078	5,484	497,627	223,258	720,885
Total	$8,239	1,974	10,213	511,738	225,529	737,267
				December 31, 2012		
	Allowance for loan losses			**Recorded investment in loans**		
	Commercial	**Consumer**	**Total**	**Commercial**	**Consumer**	**Total**
Individually evaluated	$3,534	-	3,534	15,563	-	15,563
Collectively evaluated	4,447	1,110	5,557	442,906	187,480	630,396
Total	$7,981	1,110	9,091	458,469	187,480	645,949

NOTE 4 Troubled Debt Restructurings

At December 31, 2013, we had 34 loans totaling $13.0 million and at December 31, 2012 we had 36 loans totaling $14.2 million, which we considered as TDRs. The Company considers a loan to be a TDR when the debtor experiences financial difficulties and the Company grants a concession to the debtor that it would not normally consider. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of our workout plan for individual loan relationships, we may restructure loan terms to assist borrowers facing challenges in the current economic environment. To date, we have restored two commercial loans previously classified as TDRs to accrual status.

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

(dollars in thousands)	For the year ended December 31, 2013						
	Renewals deemed a concession	**Reduced or deferred payments**	**Converted to interest only**	**Maturity date extensions**	**Total number of loans**	**Pre-modification outstanding recorded investment**	**Post-modification outstanding recorded Investment**
Commercial							
Non-owner occupied RE	1	-	-	-	1	$276	$321
Business	9	-	-	-	9	1,805	1,885
Consumer							
Real estate	1	-	-	-	1	831	835
Other	1				1	4	4
Total loans	12	-	-	-	12	$2,916	$3,045

(dollars in thousands)	For the year ended December 31, 2012						
	Renewals deemed a concession	**Reduced or deferred payments**	**Converted to interest only**	**Maturity date extensions**	**Total number of loans**	**Pre-modification outstanding recorded investment**	**Post-modification outstanding recorded Investment**
Commercial							
Owner occupied RE	1	-	-	-	1	$247	$247
Non-owner occupied RE	2	-	-	1	3	4,148	4,148
Business	6	-	1	-	7	1,909	1,994
Consumer							
Home equity	-	1	-	-	-	166	166
Total loans	9	1	1	1	11	$6,470	$6,555

The following table summarizes the TDRs that are more than 60 days past due, and have subsequently defaulted.

(dollars in thousands)	For the year ended December 31, 2013	
	Number of loans	**Recorded investment**
Consumer		
Real estate	1	$579
Total loans	1	$579

(dollars in thousands)	For the year ended December 31, 2012	
	Number of loans	**Recorded investment**
Commercial		
Owner occupied RE	1	$1,292
Non-owner occupied RE	1	29
Business	3	188
Total loans	5	$1,509

NOTE 5 Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Components of property and equipment included in the consolidated balance sheets are as follows:

	December 31,	
(dollars in thousands)	**2013**	**2012**
Land	$4,862	$3,523
Buildings	12,976	12,874
Leasehold Improvements	1,628	1,624
Furniture and equipment	5,451	5,020
Software	337	342
Construction in process	301	53
	25,555	23,436
Accumulated depreciation	(5,728)	(4,703)
Total property and equipment	$19,827	$18,733

During 2013, the Bank purchased land in Mount Pleasant, South Carolina at a cost of $1.3 million for the construction of a new retail office. Construction in process at December 31, 2013 includes various costs related to the construction of the new Mt. Pleasant office, while the December 31, 2012 balance includes various bank-related equipment not yet placed in service. Depreciation and amortization expense for the years ended December 31, 2013, 2012 and 2011 was $1.2 million, $979,000, and $884,000, respectively. Depreciation is charged to operations utilizing a straight-line method over the estimated useful lives of the assets. The estimated useful lives for the principal items follow:

Type of Asset	**Life in Years**
Software	3
Furniture and equipment	5 to 7
Leasehold improvements	5 to 15
Buildings	40

NOTE 6 Other Real Estate Owned

Other real estate owned is comprised of real estate acquired in settlement of loans and is included in other assets on the balance sheet. At December 31, 2013, other real estate owned included six properties totaling $1.2 million, compared to $1.7 million at December 31, 2012. The following summarizes the activity in the real estate acquired in settlement of loans portion of other real estate owned:

	For the year ended December 31,	
(dollars in thousands)	**2013**	**2012**
Balance, beginning of year	$1,719	3,686
Additions	1,354	1,580
Sales	(1,745)	(3,128)
Write-downs	(130)	(419)
Balance, end of year	$1,198	1,719

NOTE 7 Deposits

The following is a detail of the deposit accounts:

	December 31,	
(dollars in thousands)	**2013**	**2012**
Non-interest bearing	$101,971	80,880
Interest bearing:		
NOW accounts	153,376	158,874
Money market accounts	151,759	100,841
Savings	6,671	6,026
Time, less than $100,000	68,190	81,315
Time, $100,000 and over	198,352	148,363
Total deposits	$680,319	576,299

At December 31, 2013 and 2012, the Company had approximately $63.3 million and $13.0 million, respectively, of time deposits that were obtained outside of the Company s primary market. Interest expense on time deposits greater than $100,000 was $1.5 million, $2.0 million, and $3.5 million for the years ended December 31, 2013, 2012, and 2011, respectively.

At December 31, 2013 the scheduled maturities of certificates of deposit are as follows:

(dollars in thousands)	
2014	$165,405
2015	68,309
2016	18,808
2017	2,576
2018 and after	11,444
	$266,542

NOTE 8 Federal Home Loan Bank Advances and Other Borrowings

At December 31, 2013 and 2012, the Company had $124.1 million in FHLB advances and other borrowings. Of the $124.1 million, FHLB advances represented $103.5 million, securities sold under structured agreements to repurchase represented $19.2 million, and a line of credit represented $1.4 million.

The FHLB advances are secured with approximately $173.4 million of mortgage loans and $5.6 million of stock in the FHLB. During 2013, the Company restructured one FHLB advance of $5.0 million. In accordance with accounting guidance, we determined that the present value of the cash flows of the modified advance will not change by more than 10% from the present value of the cash flows of the original advances. Therefore, the modified FHLB advance is considered to be a restructuring and no gain or loss was recorded in the transaction. The original FHLB advance had a weighted rate of 4.07% and an average remaining life of 45 months. Under the modified arrangement, the $5.0 million in FHLB advance has a weighted average rate of 3.05% and an average remaining life of 60 months. Under a similar scenario in 2012, the Company restructured three FHLB advances totaling $45.0 million with a weighted average rate of 3.16% and average remaining life of 52 months under their original terms. Following the restructure, the weighted average rate of the three advances was 2.42% and the remaining average life was 61 months.

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Listed below is a summary of the terms and maturities of the advances at December 31, 2013 and 2012. As of December 31, 2013, $31.5 million of the Company s advances were at fixed rates, while $72.0 million were at floating rates. In addition, a number of the advances are callable and subject to repricing during 2014 at the option of the FHLB.

	December 31,			
(dollars in thousands)	**2013**		**2012**	
Maturity	**Amount**	**Rate**	**Amount**	**Rate**
September 2, 2014	$7,500	2.29%	7,500	2.36%
October 11, 2016	-	-	5,000	4.07%
October 18, 2016	7,000	2.30%	7,000	2.38%
October 18, 2016	7,500	2.47%	7,500	2.55%
October 19, 2016	10,000	2.03%	10,000	2.11%
October 19, 2016	20,000	1.60%	20,000	1.68%
February 13, 2017	7,500	4.38%	7,500	4.38%
July 11, 2017	9,000	4.49%	9,000	4.49%

July 24, 2017	5,000	4.25%	5,000	4.25%
January 30, 2018	5,000	2.92%	-	-
February 15, 2019	10,000	4.47%	10,000	4.47%
April 10, 2019	15,000	3.38%	15,000	3.48%
	$103,500		103,500	

At December 31, 2013 and 2012, the Company had four structured debt agreements secured by approximately $22.0 million of various investment securities. While these agreements are at fixed rates, they each have callable features and are subject to repricing at the option of the seller. Listed below is a summary of the terms and maturities of these structured agreements to repurchase:

(dollars in thousands)

Maturity	**Amount**	**Rate**
September 18, 2017	$10,000	3.63%
December 17, 2017	2,000	3.65%
March 14, 2018	3,600	2.75%
September 15, 2018	3,600	2.55%
	$19,200	

The Company also has an unsecured, interest only line of credit for $1.5 million with another financial institution for which $1.4 million was outstanding at December 31, 2013. The line of credit bears interest at 5.0% and matured on February 3, 2014; however, the line of credit was extended to mature on August 18, 2014 with no additional changes in terms. The loan agreement contains various financial covenants related to capital, earnings and asset quality.

NOTE 9 Junior Subordinated Debentures

On June 26, 2003, Greenville First Statutory Trust I, (a non-consolidated subsidiary) issued $6.0 million floating rate trust preferred securities with a maturity of June 26, 2033. At December 31, 2013, the interest rate was 3.35% and is indexed to the 3-month LIBOR rate and adjusted quarterly. The Company received from the Trust the $6.0 million proceeds from the issuance of the securities and the $186,000 initial proceeds from the capital investment in the Trust, and accordingly has shown the funds due to the Trust as $6.2 million junior subordinated debentures. Amortization of debt issuance costs totaled $9,000 for the year ended December 31, 2013 and $18,000 for each of the years ended December 31, 2012 and 2011, respectively, and are included in borrowings interest expense.

On December 22, 2005, Greenville First Statutory Trust II, (a non-consolidated subsidiary) issued $7.0 million floating rate trust preferred securities with a maturity of December 22, 2035. At December 31, 2013, the interest rate

was 1.69% and is indexed to the 3-month LIBOR rate and adjusted quarterly. The Company received from the Trust the $7.0 million proceeds from the issuance of the securities and the $217,000 initial proceeds from the capital investment in the Trust, and accordingly has shown the funds due to the Trust as $7.2 million junior subordinated debentures.

The current regulatory rules allow certain amounts of junior subordinated debentures to be included in the calculation of regulatory capital. However, provisions within the Dodd-Frank Wall Street Reform and Consumer Protection Act will

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prohibit institutions that had more than $15 billion in assets on December 31, 2009 from including trust preferred securities as Tier 1 capital beginning in 2013. One-third will be phased out over the next two years ending in 2015. Financial institutions with less than $15 billion in total assets, such as the Bank, may continue to include their trust preferred securities issued prior to May 19, 2010 in Tier 1 capital, but cannot include in Tier 1 capital trust preferred securities issued after such date.

NOTE 10 Unused Lines of Credit

At December 31, 2013, the Company had three lines of credit to purchase federal funds that totaled $45.0 million which were unused at December 31, 2013. The lines of credit are available on a one to ten day basis for general corporate purposes of the Company. The lender has reserved the right to withdraw the line at their option. The Company has an additional line of credit with the FHLB to borrow funds, subject to a pledge of qualified collateral. The Company has collateral that would support approximately $69.8 million in additional borrowings at December 31, 2013.

NOTE 11 Fair Value Accounting

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

to measure fair value:

Level 1 Quoted market price in active markets

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

Level 2 Significant other observable inputs

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

Level 3 Significant unobservable inputs

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

Following is a description of valuation methodologies used for assets recorded at fair value.

Investment Securities

Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange or U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities and debentures issued by government sponsored entities, municipal bonds and corporate debt securities. In certain cases where there is limited activity or less transparency around inputs to valuations, securities are classified as Level 3 within the valuation hierarchy. Securities held to maturity are valued at quoted market prices or dealer quotes similar to securities available for sale. The carrying value of Other Investments, such as Federal Reserve Bank and FHLB stock, approximates fair value based on their redemption provisions.

Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan may be considered impaired and an allowance for loan losses may be established. Loans for which it is probable that payment

of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered

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impaired. Once a loan is identified as individually impaired, management measures the impairment in accordance with FASB ASC 310, Receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2013, substantially all of the impaired loans were evaluated based on the fair value of the collateral. In accordance with FASB ASC 820, Fair Value Measurement and Disclosures, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company considers the impaired loan as nonrecurring Level 2. The Company s current loan and appraisal policies require the Company to obtain updated appraisals on an as is basis at renewal, or in the case of an impaired loan, on an annual basis, either through a new external appraisal or an appraisal evaluation. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the impaired loan as nonrecurring Level 3. The fair value of impaired loans may also be estimated using the present value of expected future cash flows to be realized on the loan, which is also considered a Level 3 valuation. These fair value estimates are subject to fluctuations in assumptions about the amount and timing of expected cash flows as well as the choice of discount rate used in the present value calculation.

Other Real Estate Owned (OREO)

OREO, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at the lower of cost or fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs (Level 2). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. Gains or losses on sale and generally any subsequent adjustments to the value are recorded as a component of real estate owned activity. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the OREO as nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis.

	December 31, 2013			
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Securities available for sale:				
US government agencies	$-	7,755	-	7,755
SBA securities	-	5,271	-	5,271
State and political subdivisions	-	23,370	-	23,370
Mortgage-backed securities	-	31,044	-	31,044
Total assets measured at fair value on a recurring basis	$-	67,440	-	67,440

	December 31, 2012			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Securities available for sale:				
US government agencies	$-	7,785	-	7,785
SBA securities	-	6,072	-	6,072
State and political subdivisions	-	25,249	-	25,249
Mortgage-backed securities	-	39,116	-	39,116
Total assets measured at fair value on a recurring basis	$-	78,222	-	78,222

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

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company is predominantly an asset based lender with real estate serving as collateral on more than 80% of loans as of December 31, 2013. Loans which are deemed to be impaired are valued net of the allowance for loan losses, and

other real estate owned is valued at the lower of cost or net realizable value of the underlying real estate collateral. Such market values are generally obtained using independent appraisals, which the Company considers to be level 2 inputs. The tables below present the recorded amount of assets and liabilities measured at fair value on a nonrecurring basis.

	December 31, 2013			
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Impaired loans	$-	10,495	1,158	11,653
Other real estate owned	-	1,085	113	1,198
Total assets measured at fair value on a nonrecurring basis	$-	11,580	1,271	12,851

	December 31, 2012			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Impaired loans	$-	13,748	191	13,939
Other real estate owned	-	1,390	329	1,719
Total assets measured at fair value on a nonrecurring basis	$-	15,138	520	15,658

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

For Level 3 assets and liabilities measured at fair value on a recurring or nonrecurring basis as of December 31, 2013, the significant unobservable inputs used in the fair value measurements were as follows:

	Valuation Technique	**Significant Unobservable Inputs**
Impaired loans	Appraised Value/ Discounted Cash Flows	Discount rate
Other real estate owned	Appraised Value/ Comparable Sales	Collateral value

Fair Value of Financial Instruments

Financial instruments require disclosure of fair value information, whether or not recognized in the consolidated balance sheets, when it is practical to estimate the fair value. A financial instrument is defined as cash, evidence of an

ownership interest in an entity or a contractual obligation which requires the exchange of cash. Certain items are specifically excluded from the disclosure requirements, including the Company s common stock, premises and equipment and other assets and liabilities.

The following is a description of valuation methodologies used to estimate fair value for certain other financial instruments.

Fair value approximates carrying value for the following financial instruments due to the short-term nature of the instrument: cash and due from banks, federal funds sold, other investments, federal funds purchased, and securities sold under agreement to repurchase.

Bank Owned Life Insurance The cash surrender value of bank owned life insurance policies held by the Company approximates fair values of the policies.

Deposits Fair value for demand deposit accounts and interest-bearing accounts with no fixed maturity date is equal to the carrying value. The fair value of certificate of deposit accounts are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

FHLB Advances and Other Borrowings Fair value for FHLB advances and other borrowings are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

Junior subordinated debentures Fair value for junior subordinated debentures are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

The Company has used management s best estimate of fair value based on the above assumptions. Thus, the fair values presented may not be the amounts that could be realized in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses, which would be incurred in an actual sale or settlement, are not taken into consideration in the fair value presented.

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

(dollars in thousands)	Carrying Amount	Fair Value	December 31, 2013 Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents	$39,203	39,203	39,203	-	-
Other investments, at cost	6,116	6,116	-	-	6,116
Loans, net	727,054	735,939	-	10,676	725,263
Bank owned life insurance	21,383	21,383	-	-	21,383
Financial Liabilities:					
Deposits	680,319	550,988	-	550,988	-
FHLB and other borrowings	124,100	135,411	-	135,411	-
Junior subordinated debentures	13,403	5,145	-	5,145	-

	Carrying Amount	Fair Value	December 31, 2012 Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents	$29,413	29,413	29,413	-	-
Other investments, at cost	7,794	7,794	-	-	7,794
Loans, net	636,858	645,852	-	13,748	632,104
Bank owned life insurance	18,725	18,725	-	-	18,725
Financial Liabilities:					
Federal funds purchased	13,190	13,190	13,190	-	-
Deposits	576,299	561,599	-	561,599	-
FHLB and other borrowings	124,100	140,455	-	140,455	-
Junior subordinated debentures	13,403	5,093	-	5,093	-

NOTE 12 Earnings Per Common Share

The following schedule reconciles the numerators and denominators of the basic and diluted earnings per share computations for the years ended December 31, 2013, 2012 and 2011. Dilutive common shares arise from the potentially dilutive effect of the Company s stock options and warrants that are outstanding. The assumed conversion of stock options and warrants can create a difference between basic and dilutive net income per common share.

At December 31, 2013, 2012 and 2011, 34,624, 74,802, and 167,937 options, respectively, were anti-dilutive in the calculation of earnings per share as their exercise price exceeded the fair market value. All earnings per share amounts have been restated to reflect the 10% stock dividends issued in January 2012 and 2013.

	December 31,		
(dollars in thousands, except share data)	**2013**	**2012**	**2011**
Numerator:			
Net income	$5,120	3,862	2,088
Less: Preferred stock dividends	771	840	865
Discount accretion	-	360	279
Add: Redemption of preferred stock	20	96	-
Net income available to common shareholders	$4,369	2,758	944
Denominator:			
Weighted-average common shares outstanding - basic	4,279,992	4,229,928	4,200,980
Common stock equivalents	178,926	110,030	85,438
Weighted-average common shares outstanding - diluted	4,458,918	4,339,958	4,286,418
Earnings per common share:			
Basic	$1.02	0.65	0.22
Diluted	$0.98	0.64	0.22

NOTE 13 Commitments and Contingencies

The Company has entered into a three year employment agreement with its chief executive officer and a two year employment agreement with its president and with six executive and senior vice presidents. These agreements also include a) an incentive program, b) a stock option plan, c) a one-year non-compete agreement upon termination and a severance payment equal to one year of compensation. The total estimated aggregate salary commitment is approximately $1.9 million.

The Company has an agreement with a data processor which expires in 2014 to provide certain item processing, electronic banking, and general ledger processing services. Components of this contract vary based on transaction and account volume and include a base monthly charge of approximately $110,000.

At December 31, 2013, the Company has a contract with a construction company for $1.3 million to construct a new office building in Mt. Pleasant, South Carolina. In addition, the Company occupied land and banking office space under leases expiring on various dates through 2028. The estimated future minimum lease payments under these noncancelable operating leases are summarized as follows:

(dollars in thousands)	**For the years ended December 31,**
2014	$776
2015	795
2016	794
2017	132
2018	137
Thereafter	1,129
	$3,763

Lease expense for the years ended December 31, 2013, 2012, and 2011, totaled $800,000, $728,000, and $684,000, respectively.

The Company may be subject to litigation and claims in the normal course of business. As of December 31, 2013, management believes there is no material litigation pending.

NOTE 14 Income Taxes

The components of income tax expense were as follows:

(dollars in thousands)	For the years ended December 31, 2013	2012	2011
Current income taxes:			
Federal	$2,747	2,031	1,627
State	129	98	63
Total current tax expense	2,876	2,129	1,690
Deferred income tax benefit	(460)	(296)	(857)
Income tax expense	$2,416	1,833	833

The following is a summary of the items that caused recorded income taxes to differ from taxes computed using the statutory tax rate:

(dollars in thousands)	For the years ended December 31, 2013	2012	2011
Tax expense at statutory rate	$2,562	1,936	993
Effect of state income taxes	85	65	74
Exempt income	(199)	(168)	(234)
Other	(32)	-	-
Income tax expense	$2,416	1,833	833

The components of the deferred tax assets and liabilities are as follows:

(dollars in thousands)	December 31, 2013	2012
Deferred tax assets:		
Allowance for loan losses	$3,472	3,091
Unrealized loss on securities available for sale	695	-
Net deferred loan fees	450	326
Interest on nonaccrual loans	627	617
Deferred compensation	833	577
Sale of real estate owned	199	212
Other	297	287
	6,573	5,110
Deferred tax liabilities:		
Property and equipment	1,225	1,188

Unrealized gain on securities available for sale	-	607
Other	410	139
	1,635	1,934
Net deferred tax asset	$4,938	3,176

The Company has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions.

NOTE 15 Related Party Transactions

Certain directors, executive officers, and companies with which they are affiliated, are clients of and have banking transactions with the Company in the ordinary course of business. These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with persons not related to the lender.

A summary of loan transactions with directors, including their affiliates and executive officers is as follows:

	For the years ended December 31,	
(dollars in thousands)	**2013**	**2012**
Balance, beginning of year	$17,404	16,968
New loans	25,830	14,081
Less loan payments	(19,767)	(13,645)
Balance, end of year	$23,467	17,404

Deposits by officers and directors and their related interests at December 31, 2013 and 2012, were $2.5 million and $2.2 million, respectively.

The Company has a land lease with a director on the property for a branch office, with monthly payments of $5,388. In addition, the Company periodically enters into various consulting agreements with the director for development, administration and advisory services related to the purchase of property and construction of current and future branch office sites. Also, the Company contracts with the director on an annual basis to provide property management services for its four offices in the Greenville market. The Company paid the director approximately $30,000, $44,000, and $39,000 for these services during 2013, 2012, and 2011, respectively.

The Company is of the opinion that the lease payments and consulting fees represent market costs that could have been obtained in similar arms length transactions.

NOTE 16 Financial Instruments With Off-Balance Sheet Risk

In the ordinary course of business, and to meet the financing needs of its clients, the Company is a party to various financial instruments with off-balance sheet risk. These financial instruments, which include commitments to extend credit and standby letters of credit, involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheets. The contract amount of those instruments reflects the extent of involvement the Company has in particular classes of financial instruments.

The Company s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amounts of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a client as long as there is no violation of any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At December 31, 2013, unfunded commitments to extend credit were approximately $138.7 million, of which $32.6 million is at fixed rates and $106.1 million is at variable rates. At December 31, 2012, unfunded commitments to extend credit were approximately $115.6 million, of which $22.1 million is at fixed rates and $93.5 million is at variable rates. The Company evaluates each client s credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management s credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, and commercial and residential real estate.

At December 31, 2013 and 2012, there was a $3.0 million and $2.3 million, respectively, commitment under letters of credit. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to clients. Collateral varies but may include accounts receivable, inventory, equipment, marketable securities and property. Since most of the letters of credit are expected to expire without being drawn upon, they do not necessarily represent future cash requirements. The fair value of off balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and

the counterparties credit standing. The total fair value of such instruments is not material.

NOTE 17 Employee Benefit Plan

On January 1, 2000, the Company adopted the Southern First Bancshares, Inc. Profit Sharing and 401(k) Plan for the benefit of all eligible employees. The Plan was amended in 2006 to provide a Roth 401(k) feature to the Plan. The

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Company contributes to the Plan annually upon approval by the Board of Directors. Contributions made to the Plan for the years ended December 31, 2013, 2012, and 2011 amounted to $235,000, $195,000, and $176,000, respectively.

The Company also provides a nonqualified deferred compensation plan for 16 executive officers in the form of a Supplemental Executive Retirement Plan (SERP). The plan provides retirement income for these officers. As of December 31, 2013 and 2012, the Company had an accrued benefit obligation of $2.5 million and $1.7 million, respectively. The Company incurred expenses related to this plan of $753,000, $497,000, and $381,000 in 2013, 2012, and 2011, respectively.

NOTE 18 Warrants and Stock Options and Grant Plans

On March 21, 2000, the Company adopted a stock option plan for the benefit of the directors, officers and employees. Under the Plan, the Board could grant up to 436,424 options at an option price per share not less than the fair market value on the date of grant. The options expire 10 years from the grant date, but expired or forfeited options may be reissued. Under the terms of the Plan any awards remaining and granted after March 2010 are accounted for as non-qualified stock options. As of January 2011, all available options under the Plan had been granted.

On May 18, 2010, the Company adopted the 2010 Incentive Plan in order to attract and retain highly qualified personnel who will contribute to the Company s success. The Plan makes available for issuance 366,025 stock options (adjusted for the 10% stock dividends in 2013, 2012, and 2011). The options may be exercised at an option price per share based on the fair market value and determined on the date of grant and expire 10 years from the grant date.

A summary of the status of the stock option plan and changes for the period (adjusted for the stock dividends in 2011, 2012, and 2013) are presented below:

	For the years ended December 31,								
	2013			2012			2011		
	Shares	Weighted average exercise price	Aggregate Intrinsic Value	Shares	Weighted average exercise price	Aggregate Intrinsic Value	Shares	Weighted average exercise price	Aggregate Intrinsic Value
Outstanding at beginning of year	556,474	$6.72		455,698	$6.76		428,469	$7.04	
Granted	90,300	9.05		120,615	6.31		87,967	6.05	
Exercised	(28,596)	6.49		(17,867)	5.36		(16,615)	4.65	
Forfeited or expired	(997)	6.49		(1,972)	5.17		(44,123)	8.76	
Outstanding at end of year	617,181	$7.05	$3,891,860	556,474	$6.72	$1,265,486	455,698	$6.76	$117,017
Options exercisable at year-end	346,509		$3,891,860	257,290		$1,265,486	181,059		$117,017
Shares available for grant	140,525			229,616			350,231		

The fair value of the option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following assumptions were used for grants: expected volatility of 43.74% for 2013, 44.04% for 2012, and 26.76% for 2011; risk-free interest rate of 1.78% for 2013, 1.86% for 2012, and 3.35% for 2011; 10 year life expectancy of the options, and; assumed dividend rate of zero.

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company s closing stock price on the last trading day of 2013 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2013. This amount changes based on the fair market value of the Company s stock.

In 2006, the Company adopted a restricted stock plan for the benefit of the directors, officers and employees. Under the restricted stock plan, 13,310 shares of restricted stock (adjusted for the stock dividends in 2011 and 2012) were authorized for issuance. As of December 31, 2012 all shares of restricted stock, authorized under the plan had been

granted. In May 2010, the Company adopted the 2010 Incentive Plan which included a provision for the issuance of 79,860 shares of restricted stock (adjusted for all subsequent stock dividends).

Shares of restricted stock granted to employees under the stock plans are subject to restrictions as to continuous employment for a specified time period following the date of grant. During this period, the holder is entitled to full voting rights and dividends.

A summary of the status of the Company s nonvested restricted stock and changes for the years ended December 31, 2013, 2012, and 2011 (adjusted for the stock dividends in 2011, 2012, and 2013) is as follows:

	December 31,					
	2013		**2012**		**2011**	
	Restricted Shares	**Weighted Average Grant-Date Fair Value**	**Restricted Shares**	**Weighted Average Grant-Date Fair Value**	**Restricted Shares**	**Weighted Average Grant-Date Fair Value**
Nonvested at beginning of year	28,119	$6.76	3,025	$6.53	-	$-
Granted	43,750	12.91	25,850	6.78	3,025	6.53
Vested	(7,219)	6.76	(756)	6.53	-	-
Forfeited	-	-	-	-	-	-
Nonvested at end of year	64,650	$10.92	28,119	$6.76	3,025	$6.53

NOTE 19 Preferred Stock Issuance

On February 27, 2009, as part of the Capital Purchase Program (CPP), the Company entered into a Securities Purchase Agreement with the U.S. Department of the Treasury (the Treasury), pursuant to which the Company sold 17,299 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series T (the Series T Preferred Stock) and a warrant to purchase 399,970.34 shares of the Company s common stock (the Warrant) for an aggregate purchase price of $17.3 million in cash. The Series T Preferred Stock qualified as Tier 1 capital and was entitled to cumulative dividends at a

rate of 5% per annum for the first five years and 9% per annum thereafter, beginning on February 27, 2014. The Warrant had a 10-year term and was immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments equal to $6.487 per share of the common stock.

On June 28, 2012, the Treasury sold its Series T Preferred Stock through a public offering structured as a modified Dutch auction. The Company bid on a portion of the Series T Preferred Stock in the auction after receiving approval from its regulators to do so. The clearing price per share for the preferred shares was $904 (compared to a par value of $1,000 per share), and the Company was successful in repurchasing 1,000 shares of the 17,299 shares of Series T Preferred Stock outstanding through the auction process. The remaining 16,299 shares of Series T Preferred Stock held by the Treasury were sold to unrelated third-parties through the auction process. Included in the September 30, 2012 operating results are approximately $130,000 of costs incurred by the Company related to the offering. These costs are not tax-deductible. The net balance sheet impact was a reduction to shareholders equity of $904,000 which is comprised of a decrease in Series T Preferred Stock of $1.0 million and a $96,000 increase to retained earnings related to the discount on the shares repurchased.

In addition, on July 25, 2012, the Company completed its repurchase of the Warrant from the Treasury for a mutually agreed upon price of $1.1 million. The difference between the fair value of the Warrant, as originally recorded, and the $1.1 million repurchase price was $343,000 which resulted in a decrease to additional paid in capital. The Company also recorded the remaining accretion of $180,000 on the Series T Preferred Stock which brought the Preferred Stock to its par value. Following the settlement of the Warrant on July 25, 2012, the Treasury has completely eliminated its equity stake in the Company through the Capital Purchase Program.

On January 3, 2013 and April 1, 2013, the Company redeemed a total of $1.0 million of its outstanding Series T preferred stock from three of its preferred shareholders. On January 27, 2014, the Company redeemed an additional 4,057 shares of its outstanding Series T Preferred Stock held by EJF at a redemption price of $1,000 per share. Since July of 2012, the Company has redeemed a cumulative $6,057,000 of its outstanding Series T Preferred Stock and reduced the balance to $11,242,000. The Company will continue to explore options and opportunities to repay the remaining preferred stock outstanding.

NOTE 20 Dividends

The ability of the Company to pay cash dividends is dependent upon receiving cash in the form of dividends from the Bank. The dividends that may be paid by the Bank to the Company are subject to legal limitations and regulatory capital requirements. Further, the Company cannot pay cash dividends on its common stock during any calendar quarter unless full dividends on the Series T preferred stock for the dividend period ending during the calendar quarter have been declared and the Company has not failed to pay a dividend in the full amount of the Series T preferred stock with respect to the period in which such dividend payment in respect of its common stock would occur. Effective May 15,

2014, the dividend rate on any outstanding Series T Preferred Stock will increase to 9% per annum from the current rate of 5%.

Also, the payment of cash dividends on the Company's common stock by the Company in the future will be subject to certain other legal and regulatory limitations (including the requirement that the Company s capital be maintained at certain minimum levels) and will be subject to ongoing review by banking regulators. The Federal Reserve has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve s policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization s capital needs, asset quality and overall financial condition.

On January 15, 2013, the Company's Board of Directors approved a ten percent stock dividend to the Company's shareholders. The record date was February 1, 2013 and the distribution date was February 15, 2013. On January 17, 2012, the Company's Board of Directors also approved a ten percent stock dividend to the Company's shareholders. The record date was February 3, 2012 and the distribution date was February 17, 2012. Earnings per share and average shares outstanding have been adjusted to reflect the stock dividend in our Consolidated Statements of Income.

NOTE 21 Regulatory Matters

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company and Bank s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the assets, liabilities, and certain off balance sheet items as calculated under regulatory accounting practices. The Bank s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Total capital includes Tier 1 and Tier 2 capital. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Management believes, as of December 31, 2013, that the Company and Bank exceed all well capitalized requirements to which they are subject.

The following table summarizes the capital amounts and ratios of the Bank and the Company and the regulatory minimum requirements at December 31, 2013 and 2012.

	Actual		**For capital adequacy purposes minimum**		**To be well capitalized under prompt corrective action provisions minimum**	
(dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2013						
The Bank						
Total Capital (to risk weighted assets)	$88,674	12.2%	58,381	8.0%	72,976	10.0%
Tier 1 Capital (to risk weighted assets)	79,538	10.9%	29,191	4.0%	43,786	6.0%
Tier 1 Capital (to average assets)	79,538	9.1%	34,989	4.0%	43,737	5.0%
The Company						
Total Capital (to risk weighted assets)	89,149	12.2%	58,381	8.0%	n/a	n/a
Tier 1 Capital (to risk weighted assets)	80,013	11.0%	29,191	4.0%	n/a	n/a
Tier 1 Capital (to average assets)	80,013	9.1%	35,063	4.0%	n/a	n/a
As of December 31, 2012						
The Bank						
Total Capital (to risk weighted assets)	$83,763	13.0%	51,498	8.0%	64,372	10.0%
Tier 1 Capital (to risk weighted assets)	75,704	11.8%	25,749	4.0%	38,623	6.0%
Tier 1 Capital (to average assets)	75,704	9.6%	31,492	4.0%	39,366	5.0%
The Company						
Total Capital (to risk weighted assets)	84,006	13.1%	51,498	8.0%	n/a	n/a
Tier 1 Capital (to risk weighted assets)	75,947	11.8%	25,749	4.0%	n/a	n/a
Tier 1 Capital (to average assets)	75,947	9.7%	31,492	4.0%	n/a	n/a

NOTE 22 Parent Company Financial Information

Following is condensed financial information of Southern First Bancshares, Inc. (parent company only):

Condensed Balance Sheets

	December 31,	
(dollars in thousands)	**2013**	**2012**
Assets		
Cash and cash equivalents	$15	82
Investment in subsidiaries	78,593	77,285
Other assets	1,876	1,578
Total assets	$80,484	78,945
Liabilities and Shareholders Equity		
Accounts payable and accrued expenses	$16	17
Other borrowings	1,400	1,400
Junior subordinated debentures	13,403	13,403
Shareholders equity	65,665	64,125
Total liabilities and shareholders equity	$80,484	78,945

Condensed Statements of Income

	For the years ended December 31,		
	2013	**2012**	**2011**
Revenues			
Interest income	$-	-	1
Total revenue	-	-	1
Expenses			
Interest expense	416	406	350
Other expenses	514	342	276
Total expenses	930	748	626
Income tax benefit	316	254	212
Loss before equity in undistributed net income of subsidiaries	(614)	(494)	(413)

Equity in undistributed net income of subsidiaries	5,734	4,356	2,501
Net income	$5,120	3,862	2,088

Condensed Statements of Cash Flows

	For the years ended December 31,		
	2013	**2012**	**2011**
Operating activities			
Net income	$5,120	3,862	2,088
Adjustments to reconcile net income to net cash used for operating activities			
Equity in undistributed net income of subsidiaries	(5,734)	(4,356)	(2,501)
Compensation expense related to stock options and restricted stock grants	515	341	276
Increase in other assets	(298)	(241)	(194)
Increase (decrease) in accounts payable and accrued expenses	(1)	11	-
Net cash used for operating activities	(398)	(383)	(331)
Investing activities			
Investment in subsidiaries	1,900	1,804	550
Net cash provided by investing activities	1,900	1,804	550
Financing activities			
Increase in note payable	-	1,400	-
Redemption of preferred stock	(980)	(1,100)	-
Redemption of CPP Warrant	-	(904)	-
Cash dividend on preferred stock	(778)	(845)	(865)
Cash in lieu	(9)	(2)	(1)
Proceeds from the exercise of stock options and warrants	198	96	77
Net cash used for financing activities	(1,569)	(1,355)	(789)
Net increase (decrease) in cash and cash equivalents	(67)	66	(570)

Cash and cash equivalents, beginning of year	82	16	586
Cash and cash equivalents, end of year	$15	82	16

NOTE 23 Selected Condensed Quarterly Financial Data (Unaudited)

	2013			
	For the quarters ended			
(dollars in thousands, except share data)	**March 31**	**June 30**	**September 30**	**December 31**
Interest income	$8,743	8,912	9,100	9,363
Interest expense	1,865	1,782	1,737	1,714
Net interest income	6,878	7,130	7,363	7,649
Provision for loan losses	1,125	750	775	825
Noninterest income	882	878	1,055	987
Noninterest expenses	5,230	5,301	5,510	5,771
Income before income tax expense	1,405	1,957	2,133	2,040
Income tax expense	444	657	714	601
Net income	961	1,300	1,419	1,439
Preferred stock dividends	197	191	191	191
Redemption of preferred stock	20	-	-	-
Net income available to common shareholders	$784	1,109	1,228	1,248
Earnings per common share				
Basic	$0.18	0.26	0.29	0.29
Diluted	$0.18	0.25	0.27	0.27
Weighted average common shares outstanding				
Basic	4,262,330	4,269,097	4,271,652	4,316,890
Diluted	4,371,324	4,423,141	4,490,026	4,551,182

2012

	For the quarters ended			
	March 31	**June 30**	**September 30**	**December 31**
Interest income	$8,557	8,534	8,790	8,817
Interest expense	2,428	2,156	2,082	2,037
Net interest income	6,129	6,378	6,708	6,780
Provision for loan losses	1,200	1,275	1,125	950
Noninterest income	837	741	1,286	897
Noninterest expenses	4,779	4,655	5,025	5,053
Income before income tax expense	987	1,189	1,844	1,674
Income tax expense	299	374	618	541
Net income	688	815	1,226	1,133
Preferred stock dividends	216	216	204	204
Discount accretion	73	106	180	-
Redemption of preferred stock	-	96	-	-
Net income available to common shareholders	$399	589	842	929
Earnings per common share				
Basic	$0.09	0.14	0.20	0.22
Diluted	$0.09	0.13	0.19	0.22
Weighted average common shares outstanding				
Basic	4,222,622	4,225,993	4,229,819	4,241,280
Diluted	4,267,813	4,436,920	4,349,971	4,305,127

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on our management s evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the Exchange Act)) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms

and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Management s Annual Report on Internal Controls Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in the *Exchange Act Rules 13a-15(f)*. A system of internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Under the supervision and with the participation of management, including the principal executive officer and the principal financial officer, the Company s management has evaluated the effectiveness of its internal control over financial reporting as of December 31, 2013 based on the criteria established in a report entitled *Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission* and the interpretive guidance issued by the Commission in Release No. 34-55929. Based on this evaluation, the Company s management has evaluated and concluded that the Company s internal control over financial reporting was effective as of December 31, 2013.

The Company is continuously seeking to improve the efficiency and effectiveness of its operations and of its internal controls. This results in modifications to its processes throughout the Company. However, there has been no change in its internal control over financial reporting that occurred during the Company s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during our fourth quarter of fiscal 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

In response to this Item, this information is contained in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 20, 2014 and is incorporated herein by reference.

Item 11. Executive Compensation.

In response to this Item, this information is contained in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 20, 2014 and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters.

In response to this Item, the information required by Item 201(d) is contained in Item 5 of this report. The other information required by this item is contained in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 20, 2014 and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions.

The information is contained in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 20, 2014 is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

In response to this Item, this information is contained in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 20, 2014 and is incorporated herein by reference.

Item 15. Exhibits, Financial Statement Schedules

(a) (1) Financial Statements

The following consolidated financial statements are located in Item 8 of this report.

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2013 and 2012

Consolidated Statements of Income for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Comprehensive Income for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Changes in Shareholders Equity for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012 and 2011

Notes to the Consolidated Financial Statements

(2) Financial Statement Schedules

These schedules have been omitted because they are not required, are not applicable or have been included in our consolidated financial statements.

(3) Exhibits

See the Exhibit Index immediately following the signature page of this report.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act), the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SOUTHERN FIRST BANCSHARES, INC.

Date: March 4, 2014	By:	/s/R. Arthur Seaver, Jr. Chief Executive Officer

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints R. Arthur Seaver, Jr., his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto the attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that the attorney-in-fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

Signature	**Title**	**Date**
/s/ R. Arthur Seaver, Jr. R. Arthur Seaver, Jr.	Director, Chief Executive Officer *(Principal Executive Officer)*	March 4, 2014
/s/ Michael D. Dowling Michael D. Dowling	Chief Financial Officer *(Principal Financial and Accounting Officer)*	March 4, 2014
/s/Andrew B. Cajka, Jr. Andrew B. Cajka, Jr.	Director	March 4, 2014
/s/Mark A. Cothran Mark A. Cothran	Director	March 4, 2014
/s/Leighton M. Cubbage Leighton M. Cubbage	Director	March 4, 2014
/s/David G. Ellison David G. Ellison	Director	March 4, 2014
/s/Anne S. Ellefson Anne S. Ellefson	Director	March 4, 2014

/s/Fred Gilmer, Jr. Fred Gilmer, Jr.	Director	March 4, 2014
/s/Tecumseh Hooper, Jr. Tecumseh Hooper, Jr.	Director	March 4, 2014
/s/Rudolph G. Johnston, III, M.D. Rudolph G. Johnstone, III, M.D.	Director	March 4, 2014

/s/James B. Orders, III James B. Orders, III	Director, Chairman	March 4, 2014
/s/William B. Sturgis William B. Sturgis	Director	March 4, 2014

EXHIBIT INDEX

3.1 Articles of Incorporation, as amended (incorporated by reference to Exhibit 3.1 of the Company s Registration Statement on Form SB-2, File No. 333-83851).

3.2	Articles of Amendment to the Articles of Incorporation establishing the terms of the Series T Preferred Stock (incorporated by reference to Exhibit 3.1 of the Company s Current Report on Form 8-K filed on March 3, 2009).
3.3	Amended and Restated Bylaws dated March 18, 2008 (incorporated by reference to Exhibit 3.4 of the Company s Form 10-K filed March 24, 2008).
4.1	See Exhibits 3.1, 3.2 and 3.3 for provisions in Southern First Bancshares s Articles of Incorporation and Bylaws defining the rights of holders of the common stock and the Series T Preferred Stock.
4.2	Form of certificate of common stock (incorporated by reference to Exhibit 4.2 of the Company s Registration Statement on Form SB-2, File No. 333-83851).
4.3	Form of Series T Preferred Stock Certificate (incorporated by reference to Exhibit 4.2 of the Company s Form 8-K filed March 3, 2009).*
10.1	2000 Greenville First Bancshares, Inc. Stock Incentive Plan and Form of Option Agreement (incorporated by reference to Exhibit 10.7 to the Company s Form 10-QSB for the period ended March 31, 2000).*
10.2	Sublease Agreement between Greenville First Bank, N.A. and Augusta Road Holdings, LLC dated February 26, 2004 (incorporated by reference to Exhibit 10.6 of the Company s Form 10-QSB for the period ended June 30, 2004).
10.3	Bonaventure I Office Lease Agreement with Greenville First Bank, N.A., dated September 20, 2005 (incorporated by reference to Exhibit 10.1 of the Company s Form 10-Q for the period ended September 30, 2005).
10.4	First Amendment to Office Lease Agreement with Greenville First Bank, N.A., dated September 20, 2005 (incorporated by reference to Exhibit 10.2 of the Company s Form 10-Q for the period ended September 30, 2005).
10.5	R. Arthur Seaver, Jr. Amended and Restated Employment Agreement (incorporated by reference to Exhibit 10.5 of the Company s Form 8-K filed October 3, 2013).*
10.6	F. Justin Strickland Amended and Restated Employment Agreement (incorporated by reference to Exhibit 10.6 of the Company s Form 8-K filed October 3, 2013).*
10.7	Frederick Gilmer, III Amended and Restated Employment Agreement (incorporated by reference to Exhibit 10.7 of the Company s Form 8-K filed October 3, 2013).*
10.8	Michael D. Dowling Amended and Restated Employment Agreement (incorporated by reference to Exhibit 10.8 of the Company s Form 8-K filed October 3, 2013).*
10.9	Form of Split Dollar Agreement between certain executives and Southern First Bancshares, Inc. (incorporated by reference to Exhibit 10.1 of the Company s Form 8-K filed February 18, 2009).*
10.10	First Amendment to the Southern First Bancshares 2000 Stock Incentive Plan, adopted October 21, 2008 (incorporated by reference to Exhibit 10.1 of the Company s Form 10-Q filed for the period ended September 30, 2008).*
10.11	Form of Southern First Bank, N.A. Salary Continuation Agreement dated December 17, 2008 (incorporated by reference to Exhibit 10.1 of the Company s Form 8-K filed December 23, 2008).*
10.12	Form of First Amendment to Southern First Bank, N.A. Salary Continuation Agreement dated December 17, 2008 (incorporated by reference to Exhibit 10.2 of the Company s Form 8-K filed December 23, 2008).*

10.13 Michael D. Dowling Salary Continuation Agreement (incorporated by reference to Exhibit 10.1 of the Company s Form 8-K filed October 3, 2013).*

10.14 F. Justin Strickland First Amendment to Salary Continuation Agreement (incorporated by reference to Exhibit 10.2 of the Company s Form 8-K filed October 3, 2013).*

10.15 Frederick Gilmer, III Second Amendment to Salary Continuation Agreement (incorporated by reference to Exhibit 10.3 of the Company s Form 8-K filed October 3, 2013).*

10.16 R. Arthur Seaver, Jr. Second Amendment to Salary Continuation Agreement (incorporated by reference to Exhibit 10.4 of the Company s Form 8-K filed October 3, 2013).*

21 Subsidiaries.

23 Consent of Independent Public Accountants.

24 Power of Attorney (contained herein as part of the signature pages).

31.1 Rule 13a-14(a) Certification of the Principal Executive Officer.

31.2 Rule 13a-14(a) Certification of the Principal Financial Officer.

32 Section 1350 Certifications of the Principal Executive Officer and Principal Financial Officer.

101 The following materials from the Company s Annual Report on Form 10-K for the year ended December 31, 2013, formatted in eXtensible Business Reporting Language (XBRL); (i) the Consolidated Balance Sheets at December 31, 2013 and December 31, 2012, (ii) Consolidated Statements of Income (Loss) for the years ended December 31, 2013, 2012, and 2011, (iii) Consolidated Statements of Changes in Shareholders Equity and Comprehensive Income (Loss) for the years ended December 31, 2013, 2012, and 2011, (iv) Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012, and 2011, and (iv) Notes to Consolidated Financial Statements.

* Management contract or compensatory plan or arrangement required to be filed as an Exhibit to this Annual Report on Form 10-K.