

REPUBLIC BANCORP INC /KY/

Form 10-Q

October 28, 2008

[Table of Contents](#)

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

Washington, D.C. 20549



## **FORM 10-Q**



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

**For the quarterly period ended September 30, 2008**



or

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

**Commission File Number: 0-24649**

## **REPUBLIC BANCORP, INC.**

(Exact name of registrant as specified in its charter)

**Kentucky**

(State of other jurisdiction of incorporation or organization)

**61-0862051**

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

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

**40202**

Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

(Address of principal executive offices)

(Zip Code)

**(502) 584-3600**

(Registrant's telephone number, including area code)

**Not Applicable**

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

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

Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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

Yes  No

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

The number of shares outstanding of the registrant's Class A Common Stock and Class B Common Stock, as of October 28, 2008, was 18,283,170 and 2,321,949, respectively.



Table of Contents

**TABLE OF CONTENTS**



PART I FINANCIAL INFORMATION

- |                |   |
|----------------|---|
| <u>Item 1.</u> | <u>Financial Statements.</u>  |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u> |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures about Market Risk.</u>                            |
| <u>Item 4.</u> | <u>Controls and Procedures.</u>   |

PART II OTHER INFORMATION

- |                 |   |
|-----------------|---|
| <u>Item 1.</u>  | <u>Legal Proceedings.</u>   |
| <u>Item 1A.</u> | <u>Risk Factors.</u>  |
| <u>Item 2.</u>  | <u>Unregistered Sales of Equity Securities and Use of Proceeds.</u> |
| <u>Item 6.</u>  | <u>Exhibits.</u>  |

SIGNATURES

Table of Contents

**PART I FINANCIAL INFORMATION**



**Item 1. Financial Statements.****CONSOLIDATED BALANCE SHEETS** (in thousands) (unaudited)

	September 30, 2008	December 31, 2007
<b>ASSETS:</b>		
Cash and cash equivalents	\$ 72,735	\$ 86,177
Securities available for sale	495,340	528,750
Securities to be held to maturity (fair value of \$51,218 in 2008 and \$52,794 in 2007)	50,988	51,886
Mortgage loans held for sale	6,758	4,278
Loans, net of allowance for loan losses of \$14,247 and \$12,735 (2008 and 2007)	2,304,126	2,384,338
Federal Home Loan Bank stock, at cost	25,082	23,955
Premises and equipment, net	42,225	39,706
Goodwill	10,168	10,168
Other assets and accrued interest receivable	37,632	36,101
<b>TOTAL ASSETS</b>	<b>\$ 3,045,054</b>	<b>\$ 3,165,359</b>
<b>LIABILITIES:</b>		
Deposits:		
Non-interest-bearing	\$ 279,260	\$ 279,457
Interest-bearing	1,521,607	1,689,355
Total deposits	1,800,867	1,968,812
Securities sold under agreements to repurchase and other short-term borrowings	322,608	398,296
Federal Home Loan Bank advances	577,294	478,550
Subordinated note	41,240	41,240
Other liabilities and accrued interest payable	25,808	29,601
<b>Total liabilities</b>	<b>2,767,817</b>	<b>2,916,499</b>
<b>STOCKHOLDERS EQUITY:</b>		
Preferred stock, no par value		
Class A Common Stock and Class B Common Stock, no par value	4,875	4,821
Additional paid in capital	122,989	119,761
Retained earnings	148,907	124,616
Unearned shares in Employee Stock Ownership Plan	(126)	(519)
Accumulated other comprehensive income	592	181
<b>Total stockholders equity</b>	<b>277,237</b>	<b>248,860</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 3,045,054</b>	<b>\$ 3,165,359</b>

See accompanying footnotes to consolidated financial statements.

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>INTEREST INCOME:</b>				
Loans, including fees	\$ 37,380	\$ 40,702	\$ 133,922	\$ 125,701
Taxable securities	6,150	7,809	19,642	21,606
Tax exempt securities	6	23	51	76
Federal Home Loan Bank stock and other	391	499	3,745	2,009
Total interest income	43,927	49,033	157,360	149,392
<b>INTEREST EXPENSE:</b>				
Deposits	7,931	14,257	30,241	40,254
Securities sold under agreements to repurchase and other short-term borrowings	1,439	4,799	5,622	14,942
Federal Home Loan Bank advances	6,077	7,678	17,862	21,392
Subordinated note	634	634	1,888	1,881
Total interest expense	16,081	27,368	55,613	78,469
<b>NET INTEREST INCOME</b>	<b>27,846</b>	<b>21,665</b>	<b>101,747</b>	<b>70,923</b>
Provision for loan losses	324	1,376	14,452	5,203
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>27,522</b>	<b>20,289</b>	<b>87,295</b>	<b>65,720</b>
<b>NON INTEREST INCOME:</b>				
Service charges on deposit accounts	5,117	4,870	14,595	13,680
Electronic refund check fees	738	77	17,668	4,189
Net RAL securitization income	157	11	13,030	3,713
Mortgage banking income	1,071	905	3,806	2,051
Debit card interchange fee income	1,194	1,105	3,589	3,216
Net loss on sales, calls and impairment of securities	(5,273)		(8,880)	
Other	410	538	1,086	1,599
Total non interest income	3,414	7,506	44,894	28,448
<b>NON INTEREST EXPENSES:</b>				
Salaries and employee benefits	12,611	11,051	39,726	34,703
Occupancy and equipment, net	4,878	4,461	14,304	12,795
Communication and transportation	1,024	859	3,246	2,561
Marketing and development	853	815	8,342	2,482
Bank franchise tax expense	599	629	2,025	1,922
Data processing	646	679	2,032	1,907
Debit card interchange expense	624	591	1,812	1,681
Supplies	328	391	1,257	1,299
Other	2,420	1,802	8,546	6,428
Total non interest expenses	23,983	21,278	81,290	65,778

Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

<b>INCOME BEFORE INCOME TAX EXPENSE</b>	6,953	6,517	50,899	28,390
<b>INCOME TAX EXPENSE</b>	2,451	2,285	17,851	9,883
<b>NET INCOME</b>	\$ 4,502	\$ 4,232	\$ 33,048	\$ 18,507



Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
<b>OTHER COMPREHENSIVE INCOME, NET OF TAX</b>				
Unrealized loss on securities available for sale	\$ 93	\$ 1,898	\$ (5,661)	\$ 1,293
Realized impairment loss on securities, net	3,428		6,072	
Other comprehensive loss, net	3,521	1,898	411	1,293
<b>COMPREHENSIVE INCOME</b>	<b>\$ 8,023</b>	<b>\$ 6,130</b>	<b>\$ 33,459</b>	<b>\$ 19,800</b>
<b>BASIC EARNINGS PER SHARE:</b>				
Class A Commons Stock	\$ 0.22	\$ 0.21	\$ 1.62	\$ 0.91
Class B Common Stock	0.21	0.20	1.59	0.88
<b>DILUTED EARNINGS PER SHARE:</b>				
Class A Commons Stock	\$ 0.22	\$ 0.21	\$ 1.59	\$ 0.88
Class B Common Stock	0.20	0.20	1.56	0.86

*See accompanying footnotes to consolidated financial statements.*

Table of Contents**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY (UNAUDITED)**

(in thousands, except per share data)	Class A Shares Outstanding	Common Stock Class B Shares Outstanding	Amount	Additional Paid In Capital	Retained Earnings	Unearned Shares in Empl. Stock Ownership Plan	Accumulated Other Comprehensive Income / (Loss)	Total Stockholders Equity
Balance, January 1, 2008	17,958	2,344	\$ 4,821	\$ 119,761	\$ 124,616	\$ (519)	\$ 181	\$ 248,860
Net income					33,048			33,048
Net change in accumulated other comprehensive loss							411	411
Dividend declared Common Stock:								
Class A (\$0.352 per share)					(6,404)			(6,404)
Class B (\$0.320 per share)					(746)			(746)
Stock options exercised, net of shares redeemed	284		58	2,695	(1,280)			1,473
Repurchase of Class A Common Stock	(19)		(4)	(112)	(327)			(443)
Conversion of Class B Common Stock to Class A Common Stock	22	(22)						
Shares committed to be released under the Employee Stock Ownership Plan	37			458		393		851
Notes receivable on Common Stock, net of cash payments				(377)				(377)
Deferred director compensation expense - Company Stock	1			111				111
Stock based compensation expense				453				453
Balance, September 30, 2008	18,283	2,322	\$ 4,875	\$ 122,989	\$ 148,907	\$ (126)	\$ 592	\$ 277,237

See accompanying footnotes to consolidated financial statements.

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

NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007 (in thousands)

	2008	2007
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 33,048	\$ 18,507
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion, net	5,535	1,163
Federal Home Loan Bank stock dividends	(956)	(342)
Provision for loan losses	14,452	5,203
Net gain on sale of mortgage loans held for sale	(3,572)	(1,483)
Origination of mortgage loans held for sale	(196,150)	(169,124)
Proceeds from sale of mortgage loans held for sale	197,242	171,901
Net gain on sale of RALs	(8,313)	(2,261)
Increase in RAL securitization residual	(4,717)	(1,452)
Origination of RALs sold	(1,098,717)	(350,414)
Proceeds from sale of RALs	1,009,698	321,407
Paydown of securitization residual	106,776	33,701
Net realized loss on sales, calls and impairment of securities	8,880	
Net (gain)/loss on sale of other real estate owned	5	(21)
Net gain on sale of premises and equipment	(43)	
Deferred director compensation expense    Company Stock	111	118
Employee Stock Ownership Plan compensation expense	851	657
Stock based compensation expense	453	727
Net change in other assets and liabilities:		
Accrued interest receivable	(3,160)	(3,228)
Accrued interest payable	(3,399)	(1,211)
Other assets	(3,657)	2,761
Other liabilities	(874)	1,737
Net cash provided by operating activities	53,493	28,346
<b>INVESTING ACTIVITIES:</b>		
Purchases of securities available for sale	(1,891,435)	(2,987,657)
Purchases of Federal Home Loan Bank stock	(531)	(502)
Proceeds from calls, maturities, sales and paydowns of securities available for sale	1,916,724	2,953,259
Proceeds from calls, maturities and paydowns of securities to be held to maturity	865	2,434
Proceeds from the sale of Federal Home Loan Bank stock	360	
Proceeds from sales of other real estate owned	3,103	1,243
Net (increase) decrease in loans	61,143	(100,645)
Purchases of premises and equipment	(7,259)	(6,376)
Proceeds from sale of premises and equipment	848	
Net cash provided by/(used in) investing activities	83,818	(138,244)
<b>FINANCING ACTIVITIES:</b>		
Net change in deposits	(167,948)	41,584
Net change in securities sold under agreements to repurchase and other short-term borrowings	(75,688)	(48,603)
Payments on Federal Home Loan Bank advances	(123,256)	(293,135)
Proceeds from Federal Home Loan Bank advances	222,000	416,200
Repurchase of Common Stock	(443)	(9,299)
Net proceeds from Common Stock options exercised	1,473	1,284
Cash dividends paid	(6,891)	(6,072)
Net cash (used in)/provided by financing activities	(150,753)	101,959

<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>		(13,442)		(7,939)
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>		86,177		81,613
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	\$	72,735	\$	73,674

Table of Contents

	2008	2007
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for:		
Interest	\$ 59,012	\$ 79,681
Income taxes	20,055	9,711
<b>SUPPLEMENTAL NONCASH DISCLOSURES:</b>		
Transfers from loans to real estate acquired in settlement of loans	\$ 4,330	\$ 777
Retained securitization residual	102,059	32,314

*See accompanying footnotes to consolidated financial statements.*

Table of Contents

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2008 AND 2007 (UNAUDITED) AND DECEMBER 31, 2007**

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

**Basis of Presentation** The consolidated financial statements include the accounts of Republic Bancorp, Inc. (the Parent Company ) and its wholly-owned subsidiaries: Republic Bank & Trust Company ( RB&T ) and Republic Bank (collectively referred together with RB&T as the Bank ), Republic Funding Company and Republic Invest Co. On August 15, 2008, the Company filed applications with the Office of Thrift Supervision to merge Republic Bank & Trust Company, a state chartered commercial bank, and Republic Bank, a federally chartered savings bank, into one federally chartered savings bank. Republic Invest Co. includes its subsidiary, Republic Capital LLC. The consolidated financial statements also include the wholly-owned subsidiaries of RB&T: Republic Financial Services, LLC, TRS RAL Funding, LLC and Republic Insurance Agency, LLC. Republic Bancorp Capital Trust ( RBCT ) is a Delaware statutory business trust that is a wholly-owned, unconsolidated finance subsidiary of Republic Bancorp, Inc. All companies are collectively referred to as Republic or the Company. All significant intercompany balances and transactions are eliminated in consolidation.

Republic operates 45 banking centers, primarily in the retail banking industry, and conducts its operations predominately in metropolitan Louisville, Kentucky, central Kentucky, northern Kentucky, southern Indiana, metropolitan Tampa, Florida, metropolitan Cincinnati, Ohio and through an Internet banking delivery channel. Republic s consolidated results of operations are primarily dependent upon net interest income, which represents the difference between the interest income and fees on interest-earning assets and the interest expense on interest-bearing liabilities. Principal interest-earning assets represent securities and real estate mortgage, commercial and consumer loans. Interest-bearing liabilities primarily consist of interest-bearing deposit accounts, as well as short-term and long-term borrowing sources.

Other sources of banking income include service charges on deposit accounts, debit card interchange income, title insurance commissions, fees charged to customers for trust services and revenue generated from Mortgage Banking activities, which represents both the origination and sale of loans in the secondary market and the servicing of loans for others.

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

RB&T, through its Tax Refund Solutions ( TRS ) business segment, is one of a limited number of financial institutions which facilitates the payment of federal and state tax refunds through tax-preparers located throughout the U.S. Substantially all of the business generated by TRS occurs in the first quarter of the year. The Company facilitates the payment of these tax refunds through three primary products: Refund Anticipation Loans ( RALs ), Electronic Refund Checks ( ERCs ) and Electronic Refund Deposits ( ERDs ).

## Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

RALs are short-term consumer loans offered to taxpayers, secured by their anticipated tax refund, which represents the source of repayment. At the request of the taxpayer, the refund claim is paid by the Internal Revenue Service ( IRS ) to the Company once the tax return has been processed. Funds received from the IRS above the sum of the RAL less associated fees are remitted to the taxpayer by the Company. The funds advanced by the Company are generally repaid by the IRS within two weeks. The fees earned on RALs are reported as interest income under the line item Loans, including fees.

ERCs/ERDs are products whereby a tax refund is issued to the taxpayer after RB&T has received the refund from the federal or state government. Fees earned on ERCs/ERDs are reported as non interest income under the line item Electronic Refund Check fees.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included. Operating results for

Table of Contents

three and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information, refer to the consolidated financial statements and footnotes thereto included in Republic's Form 10-K for the year ended December 31, 2007.

**Securitization** The Company utilized a securitization structure to fund, over a four week period, a portion of the RALs originated during the first quarters of 2008 and 2007. The securitization consisted of \$1.1 billion and \$350 million of loans originated and sold during January and February of 2008 and 2007, respectively. The Company's continuing involvement in loans sold into the securitization was limited to only servicing the RALs. Compensation for servicing the securitized RALs was not contingent upon the performance of the securitized RALs.

Historically, from mid January to the end of February of each year, RALs which, upon origination, met certain underwriting criteria related to refund amount and Earned Income Tax Credit amount, were classified as loans held for sale and sold into the securitization. All other RALs originated were retained by the Company. There were no RALs held for sale as of any quarter end. The Company retained a related residual value in the securitization, which was classified on the balance sheet as a trading security. The initial residual interest had a weighted average life of approximately one month, and as such, substantially all of its cash flows were received by the end of the first quarter. The disposition of the remaining anticipated cash flows occurred within the remainder of the calendar year. At its initial valuation, and on a quarterly basis thereafter, the Company adjusted the carrying amount of the residual value to its fair value, which was determined based on expected future cash flows and was significantly influenced by the anticipated credit losses of the underlying RALs.

The Company concluded that the transaction was a sale as defined in Statement of Financial Accounting Standards ( SFAS ) 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities-a replacement of FASB Statement No. 125*. This conclusion was based on, among other things, legal isolation of assets, the ability of the purchaser to pledge or sell the assets, and the absence of a right or obligation of the Company to repurchase the financial assets.

*See the sections titled Business Segment Composition and Results of Operations in Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as Footnote 3 Loans and Allowance for Loans Losses, Footnote 9 Segment Information and Footnote 10 Securitization of Part I Item 1 Financial Statements and Part II Item 1A Risk Factors for additional discussion regarding TRS and the securitization.*

**Recently Issued Accounting Pronouncements** In March 2008, the Financial Accounting Standards Board ( FASB ) issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*. SFAS 161 requires enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related items are accounted for under SFAS 133 and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. The new standard is effective for the Company on January 1, 2009. The Company is currently evaluating the impact of adopting SFAS 161 on the consolidated financial statements.

In October, 2008, the FASB issued FSP No. 157-3 *Determining the Fair Value of a Financial Asset When the Market for that Asset Is Not Active*. The FSP clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key consideration in determining the fair value of a financial asset with the market for that financial asset is not active.



**Reclassifications** Certain amounts presented in prior periods have been reclassified to conform to the current period presentation.

Table of Contents**2. SECURITIES****Trading securities:**

Trading securities consisting of residual interest in the RAL securitization totaled \$0 at September 30, 2008 and December 31, 2007.

**Securities available for sale:**

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

September 30, 2008 (in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and U.S. Government agencies	\$ 89,522	\$ 578	\$	\$ 90,100
Non agency mortgage backed and other non agency mortgage-related securities	22,657		(1,538)	21,119
Mortgage backed securities	306,918	2,734	(894)	308,758
Collateralized mortgage obligations	75,333	154	(124)	75,363
Total securities available for sale	\$ 494,430	\$ 3,466	\$ (2,556)	\$ 495,340

December 31, 2007 (in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and U.S. Government agencies	\$ 159,524	\$ 841	\$ (90)	\$ 160,275
Freddie Mac preferred stock	2,000		(459)	1,541
Non agency mortgage backed and other non agency mortgage-related securities	34,644		(2,169)	32,475
Mortgage backed securities	318,041	2,484	(452)	320,073
Collateralized mortgage obligations	14,262	136	(12)	14,386
Total securities available for sale	\$ 528,471	\$ 3,461	\$ (3,182)	\$ 528,750

Table of Contents**Securities to be held to maturity:**

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

September 30, 2008 (in thousands)	Carrying Value	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
U.S. Treasury securities and U.S. Government agencies	\$ 4,666	\$ 5	\$	\$ 4,671
Obligations of states and political subdivisions	384	15		399
Mortgage backed securities	3,691	18	(70)	3,639
Collateralized mortgage obligations	42,247	338	(76)	42,509
Total securities to be held to maturity	\$ 50,988	\$ 376	\$ (146)	\$ 51,218

December 31, 2007 (in thousands)	Carrying Value	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
U.S. Treasury securities and U.S. Government agencies	\$ 4,672	\$ 7	\$	\$ 4,679
Obligations of states and political subdivisions	383	25		408
Mortgage backed securities	4,448	4	(80)	4,372
Collateralized mortgage obligations	42,383	970	(18)	43,335
Total securities to be held to maturity	\$ 51,886	\$ 1,006	\$ (98)	\$ 52,794

Table of Contents**Market Loss Analysis**

Securities with unrealized losses at September 30, 2008 and December 31, 2007, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

September 30, 2008 (in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Non agency mortgage backed and other non agency mortgage-related securities	\$ 7,947	\$ (277)	\$ 7,508	\$ (1,261)	\$ 15,455	\$ (1,538)
Mortgage backed securities, including CMOs	137,315	(1,076)	2,832	(88)	140,147	(1,164)
<b>Total</b>	<b>\$ 145,262</b>	<b>\$ (1,353)</b>	<b>\$ 10,340</b>	<b>\$ (1,349)</b>	<b>\$ 155,602</b>	<b>\$ (2,702)</b>

December 31, 2007 (in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and U.S. Government agencies	\$ 63,438	\$ (55)	\$ 19,959	\$ (35)	\$ 83,397	\$ (90)
Freddie Mac preferred stock	1,541	(459)			1,541	(459)
Obligations of states and political subdivisions						
Non agency mortgage backed and other non agency mortgage-related securities	29,719	(2,132)	2,756	(37)	32,475	(2,169)
Mortgage backed securities, including CMOs	26,313	(126)	43,067	(436)	69,380	(562)
<b>Total</b>	<b>\$ 121,011</b>	<b>\$ (2,772)</b>	<b>\$ 65,782</b>	<b>\$ (508)</b>	<b>\$ 186,793</b>	<b>\$ (3,280)</b>

**Other-than-temporary Impairment ( OTTI ) Analysis**

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

- How much fair value has declined below amortized cost;
- How long the decline in fair value has existed;

- The financial condition of the issuer;
- Significant rating agency changes on the issuer; and
- The Company's intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.

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

Table of Contents

Nationally, residential real estate values declined significantly during 2007 and 2008. These declines in value, coupled with the reduced ability of certain homeowners to refinance or repay their residential real estate obligations, have led to elevated delinquencies and losses in residential real estate loans. Many of these loans have previously been securitized and sold to investors as non agency mortgage backed or other non agency mortgage-related securities. The Company currently owns five non agency mortgage backed and other non agency mortgage-related securities with a fair value of \$21.1 million at September 30, 2008. These securities are not guaranteed by government agencies. Approximately \$14.4 million (*Securities 1 through 4 in the table below*) of these securities are mostly backed by Alternative A first lien mortgage loans. The remaining \$6.7 million (*Security 5 in the table below*) represents an asset backed security with an insurance wrap or guarantee. The average life of these securities is currently estimated to be approximately five years. Due to current market conditions, all of these assets are extremely illiquid, and as such, the Company determined that these securities are Level 3 securities in accordance with FSP No. 157-3 *Determining the Fair Value of a Financial Asset When the Market for that Asset Is Not Active*, which was issued in October 2008. Based on this determination, the Company utilized an income valuation model as of September 30, 2008, as opposed to a market valuation approach, in determining the fair value of these securities. The income valuation model (present value model) maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Management believes the income valuation model is more representative of the fair value for these securities than the market valuation technique used at prior measurement dates.

Prior to the second quarter of 2008, unrealized losses on the Company's non agency mortgage backed securities and other non agency mortgage related securities were not recognized into income because the bonds were deemed to be of sufficient credit quality (rated A+, Aa1 or higher) and the Company had the intent and ability to hold the securities until maturity. The Company evaluated the performance of the loans underlying these securities and concluded it would likely continue to receive the future expected cash flows of these securities in accordance with their original terms. As such, prior to the second quarter of 2008, the Company concluded that the fair value of all non agency mortgage backed securities and other non agency mortgage related securities would recover as the securities approached maturity.

During the second quarter of 2008, the Company recorded a non cash OTTI charge of \$3.4 million for two of its available for sale non agency mortgage backed securities and other non agency mortgage related securities (*Security 2 and Security 5 in the table below*). In determining that *Security 2* was other-than-temporarily impaired, the Company gave considerable weight to the significance of the downgrade of the security by Standard and Poor's (S&P) in June of 2008. The downgrade raised doubt about the ability of the Company to continue to collect future principal and interest payments from the security in accordance with its original terms. In evaluating *Security 5*, the Company gave considerable weight to the rating downgrade and subsequent withdrawal of the security's rating by Fitch in June of 2008. In addition, the Company also gave consideration to the deterioration of the financial condition of the insurer providing the insurance wrap on the security.

During the third quarter of 2008, the Company recorded a non cash OTTI charge totaling \$3.9 million for one of its available for sale non-agency mortgage related securities (*Security 1 in the table below*). This security was downgraded in August by Moody's from a rating of Aa1 to a rating of Baa2. In evaluating *Security 1*, the Company gave considerable weight to the significant downgrade of this security by Moody's. The downgrade raised doubt about the ability of the Company to continue to collect the future principal and interest payments from the security in accordance with its original terms.

As a result of the three impairment charges noted above, all unrealized losses were transferred from accumulated other comprehensive loss to an immediate reduction of earnings classified as net loss on sales, calls and impairments of securities in the consolidated statement of income and comprehensive income.

With regard to *Security 3* and *Security 4* in the table below, unrealized losses were not recognized into income because the bonds are of sufficient credit quality (AAA or higher) and the Company has the intent and ability to hold until maturity. The Company has evaluated the performance of the loans underlying these securities and concluded it would likely continue to receive the future expected cash flows of these securities in accordance with original terms. As such, the Company has concluded that the fair value of *Security 3* and *Security 4* in the table

below would recover as the securities approach maturity.

Table of Contents

Detail for non agency mortgage backed and other non agency mortgage-related securities as of September 30, 2008 follows:

(in thousands)	Amortized Cost	Estimated Fair Value	Unrealized Loss	S&P	Ratings Fitch	Moody s
Security 1	\$ 7,202	\$ 7,202	\$	AAA		Baa2
Security 2	1,168	956	(212)	BB		B3
Security 3	5,222	4,323	(899)	AAA	AAA	
Security 4	2,286	1,924	(362)	AAA	AAA	
Security 5	6,779	6,714	(65)	AA		
<b>Total</b>	<b>\$ 22,657</b>	<b>\$ 21,119</b>	<b>\$ (1,538)</b>			

During the first quarter of 2008, the Company determined that its Freddie Mac ( FHLMC ) preferred stock investment, with an aggregate carrying value at the time of \$2 million, was other-than-temporarily impaired and recorded an impairment charge of \$680,000. During September 2008, the U.S. Treasury, the Federal Reserve, and the Federal Housing Finance Agency ( FHFA ) announced that the FHFA was placing FHLMC under conservatorship, giving management control to the FHFA. As a result, during the third quarter of 2008, the fair market value of the security declined significantly and the Company recorded another impairment charge of \$1.4 million. With the third quarter impairment charge, the Company completely wrote down the value of the investment to \$0.

**Pledged Securities**

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

(in thousands)	September 30, 2008	December 31, 2007
Amortized cost	\$ 424,823	\$ 518,947
Fair value	425,035	519,834



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

(in thousands)	September 30, 2008	December 31, 2007
Residential real estate	\$ 1,118,254	\$ 1,168,591
Commercial real estate	650,213	658,987
Real estate construction	117,606	163,700
Commercial	101,643	90,741
Consumer	28,543	33,310
Overdrafts	1,501	1,238
Home equity	300,613	280,506
Total loans	2,318,373	2,397,073
Less: Allowance for loan losses	14,247	12,735
Loans, net	\$ 2,304,126	\$ 2,384,338

An analysis of the changes in the allowance for loan losses follows:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Allowance for loan losses at beginning of period	\$ 17,995	\$ 11,157	\$ 12,735	\$ 11,218
Provision for loan losses	324	1,376	14,452	5,203
Charge offs Banking	(3,331)	(756)	(5,325)	(1,709)
Charge offs Tax Refund Solutions	(1,335)	(6)	(9,208)	(4,246)
Recoveries Banking	356	171	743	683
Recoveries Tax Refund Solutions	238	160	850	953
Allowance for loan losses at end of period	\$ 14,247	\$ 12,102	\$ 14,247	\$ 12,102

Information regarding Republic's impaired loans follows:

(in thousands)	September 30, 2008	December 31, 2007
Loans with no allocated allowance for loan losses	\$	\$
Loans with allocated allowance for loan losses	12,525	6,412
Total	\$ 12,525	\$ 6,412
Amount of the allowance for loan losses allocated	\$ 1,862	\$ 1,498
Average investment in impaired loans	13,771	9,425

Interest income recognized during impairment  
Interest income recognized on a cash basis on  
impaired loans

Table of Contents

Detail of non performing loans and non performing assets follows:

(dollars in thousands)	September 30, 2008	December 31, 2007
Loans on non-accrual status	\$ 14,763	\$ 8,303
Loans past due 90 days or more and still on accrual	1,217	1,318
Total non-performing loans	15,980	9,621
Other real estate owned	2,017	795
Total non-performing assets	\$ 17,997	\$ 10,416
Non-performing loans to total loans	0.69%	0.40%
Non-performing assets to total loans	0.78	0.43

The following table details RAL originations and loss reserves for three and nine months ended September 30, 2008 and 2007:

(in thousands)	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
<b>Originations:</b>				
RALs originated and retained on balance sheet	\$ 773	\$ 580	\$ 682,877	\$ 226,783
RALs originated and securitized			1,098,717	350,414
Total RALs originated	\$ 773	\$ 580	\$ 1,781,594	\$ 577,197
<b>Estimated RAL losses:</b>				
Estimated losses for retained RALs, net	\$ 133	\$ (154)	\$ 8,358	\$ 3,293
Net reduction to estimated future expected cash flows for securitized RALs	(132)	(6)	6,697	2,010
Total Estimated RALs losses, net	\$ 1	\$ (160)	\$ 15,055	\$ 5,303

**RAL Loss Reserves and Provision for Loan Losses:**

Substantially all RALs issued by the Company each year are made during the first quarter. Losses associated with RALs result from the IRS not remitting taxpayer refunds to the Company associated with a particular tax return. This occurs for a number of reasons, including errors in the tax return and tax return fraud. At March 31st of each year, with adjustments each quarter end thereafter, the Company reserves for its estimated RAL losses based on current year and historical funding patterns and information received from the IRS regarding current year payment processing. The Company applies its loss estimates to both RALs retained on balance sheet and to securitized RALs. The Company applies loss estimates to securitized RALs because the securitization residual is valued based on the future expected cash flows of the securitization, which is significantly influenced by the anticipated credit losses of the underlying RALs. Estimated losses related to securitized RALs are recorded in non interest income as a reduction to Net RAL securitization income.

As of September 30, 2008, \$9.2 million of total RALs retained on balance sheet remained uncollected compared to \$3.9 million at September 30, 2007, representing 1.35% and 1.72% of total gross RALs originated and retained on balance sheet during the respective tax years by the Company. As a result, the Company recorded a net provision for loan losses of \$8.4 million during the first nine months of 2008 compared to \$3.3 million during the first nine months of 2007. The Company recorded an additional provision for loan losses of \$133,000 during the third quarter of 2008 compared to a net credit to the provision of \$154,000 during the same period in 2007. The decrease in RAL losses as a percent of total RALs retained on balance sheet from year to year is attributable primarily to revised underwriting standards and a reduction in known fraud resulting from improved fraud detection techniques utilized by the Company.

Table of Contents

As of September 30, 2008, \$7.0 million of securitized RALs remained uncollected compared to \$2.3 million at September 30, 2007, representing 0.64% and 0.67% of total gross RALs securitized by the Company during the respective tax years. As a result, the Company recorded a net reduction to Net RAL securitization income of \$6.7 million for the first nine months of 2008 compared to \$2.0 million for the first nine months of 2007. The Company recorded a net credit to Net RAL securitization income of \$132,000 and \$6,000 during the third quarters of 2008 and 2007. As with the RALs retained on balance sheet, the decrease in securitized RAL losses as a percent of total RALs securitized from year to year is attributable primarily to revised underwriting standards and a reduction in known fraud resulting from improved fraud detection techniques utilized by the Company.

The overall earnings of the TRS segment are highly dependent upon the Company's loss estimates for RALs retained on balance sheet and securitized RALs. The Company believes that based on information currently available, it has provided the appropriate amount of reserves for losses associated with RALs. At September 30, 2008, the Company had effectively fully reserved for all uncollected RALs, both securitized and retained on balance sheet. The possibility remains, however, that additional payments could be received from the IRS during the fourth quarter of 2008 resulting in an adjustment to the Company's previous allowance for loan losses and residual interest, or trading security. The Company believes that any payments received from the IRS during the fourth quarter of 2008 will be immaterial and recorded as an adjustment to income if received.

*See the sections titled Business Segment Composition and Results of Operations in Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as Footnote 9 Segment Information and Footnote 10 Securitization of Part I Item 1 Financial Statements and Part II Item 1A Risk Factors for additional discussion regarding TRS and the securitization.*

#### 4. DEPOSITS

(in thousands)	September 30, 2008	December 31, 2007
Demand (NOW and SuperNOW)	\$ 204,071	\$ 197,949
Money market accounts	596,667	635,590
Internet money market accounts	8,204	10,521
Savings	31,446	30,362
Individual retirement accounts	39,106	37,865
Certificates of deposit, \$100,000 and over	190,874	174,538
Other certificates of deposit	240,580	231,143
Brokered deposits	210,659	371,387
Total interest-bearing deposits	1,521,607	1,689,355
Total non interest-bearing deposits	279,260	279,457
Total	\$ 1,800,867	\$ 1,968,812

Table of Contents**5. FEDERAL HOME LOAN BANK ( FHLB ) ADVANCES**

(in thousands)	September 30, 2008	December 31, 2007
FHLB putable fixed interest rate advances with a weighted average interest rate of 4.51%(1)	\$ 150,000	\$ 150,000
Overnight FHLB advances with an interest rate of 3.20%	11,000	35,000
FHLB fixed interest rate advances with a weighted average interest rate of 3.84% due through 2035	416,294	293,550
Total FHLB advances	\$ 577,294	\$ 478,550

(1) Represents putable advances with the FHLB. These advances have original fixed rate periods ranging from one to five years with original maturities ranging from three to ten years if not put back to the Company earlier by the FHLB. At the end of their respective fixed rate periods and on a quarterly basis thereafter, the FHLB has the right to require payoff of the advances by the Company at no penalty. During the first quarter of 2007, the Company entered into \$100 million of putable advances with a final maturity of 10 years and a fixed rate period of 3 years. Based on market conditions at this time, the Company does not believe that any of its putable advances are likely to be put back to the Company in the short-term by the FHLB.

Each FHLB advance is payable at its maturity date, with a prepayment penalty for fixed rate advances paid off earlier than maturity. FHLB advances are collateralized by a blanket pledge of eligible real estate loans. At September 30, 2008, Republic had available collateral to borrow an additional \$375 million from the FHLB. In addition to its borrowing line with the FHLB, Republic also had unsecured lines of credit totaling \$207 million available through various other financial institutions.

Aggregate future principal payments on FHLB advances, based on contractual maturity dates are detailed below:

Year	(in thousands)
2008	\$ 72,000
2009	107,000
2010	92,370
2011	100,000
2012	70,000
Thereafter	135,924
Total	\$ 577,294

The following table illustrates real estate loans pledged to collateralize advances and letters of credit from the FHLB:

(in thousands)	September 30, 2008	December 31, 2007
----------------	-----------------------	----------------------

Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

First lien, single family residential	\$	819,424	\$	853,642
Home equity lines of credit		120,062		113,971
Multi-family, commercial real estate		25,353		29,342

Table of Contents

**6. FAIR VALUE**

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements*. SFAS 157 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. SFAS 157 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.

In October, 2008, the FASB issued FSP No. 157-3 *Determining the Fair Value of a Financial Asset When the Market for that Asset Is Not Active*. The FSP clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key consideration in determining the fair value of a financial asset with the market for that financial asset is not active.

SFAS 157 describes three levels of inputs that may be used to measure fair value:

**Level 1:** Quoted prices (unadjusted) for identical assets or liabilities in active markets that an entity has the ability to access as of the measurement date, or observable inputs.

**Level 2:** Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

**Level 3:** Significant unobservable inputs that reflect an entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. When that occurs, the Company classifies the fair value hierarchy on the lowest level of input that is significant to the fair value measurement. The Company uses the following methods and significant assumptions to estimate fair value:

**Trading securities:** The Company's residual interest for securitized RALs is classified as a trading security. The fair value of the trading security is determined by analyzing expected future cashflows and is significantly influenced by the anticipated credit losses of the underlying RALs. Factors that the Company applies in determining the fair value include current year and historical funding patterns, as well as, information received from the IRS regarding current year payment processing. These securities are classified as Level 3 in the fair value hierarchy.



**Securities available for sale:** For all securities available for sale, excluding non agency mortgage backed and other non agency mortgage related securities, fair value is typically determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities. Matrix pricing relies on the securities' relationship to similarly traded securities, benchmark curves, and the benchmarking of like securities. Matrix pricing utilizes observable market inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. In instances where broker quotes are used, these quotes are obtained from market makers or broker-dealers recognized to be market participants. These securities are classified as Level 2 in the fair value hierarchy.

The Company currently owns five non agency mortgage backed and other non agency mortgage-related securities with a carrying value of \$22.7 million at September 30, 2008. These securities are not guaranteed by government agencies. Approximately \$14.4 million of these securities are backed by Alternative A first lien mortgage loans. The remaining \$6.7 million represents an asset backed security with an insurance wrap or guarantee. Due to current market conditions, all of these assets are extremely illiquid based on guidance outlined in FSP 157-3, and as such, the Company has classified them in the Level 3 hierarchy for fair value reporting. The average life of these securities is currently estimated to be approximately five years. The Company utilized an income valuation model

Table of Contents

(present value model) approach, in determining the fair value of these securities. This approach maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs.

**Derivative instruments:** Mortgage Banking derivatives used in the ordinary course of business consist of mandatory forward sales contracts ( forward contracts ) and rate lock loan commitments. Forward contracts represent future commitments to deliver loans at a specified price and date and are used to manage interest rate risk on loan commitments and mortgage loans held for sale. Rate lock commitments represent commitments to fund loans at a specific rate. These derivatives involve underlying items, such as interest rates, and are designed to transfer risk. Substantially all of these instruments expire within 90 days from the date of issuance. Notional amounts are amounts on which calculations and payments are based, but which do not represent credit exposure, as credit exposure is limited to the amounts required to be received or paid. The fair value of our derivative instruments is primarily measured by obtaining pricing from broker-dealers recognized to be market participants. The pricing is derived from market observable inputs that can generally be verified and do not typically involve significant judgment by the Company. Forward contracts and loan commitments are classified as Level 2 in the fair value hierarchy.

**Mortgage loans held for sale:** The fair value of mortgage loans held for sale is determined using quoted secondary-market prices. The purchaser provides the Company with a commitment to purchase the loan at the origination price. This commitment qualifies as an exit price under SFAS 157 and therefore mortgage loans held for sale are classified as Level 2 in the fair value hierarchy. If no such quoted price exists, the fair value of a loan would be determined using quoted prices for a similar asset or assets, adjusted for the specific attributes of that loan.

**Impaired Loans:** Impairment is evaluated at the time a loan is identified as impaired and the loan is recorded at the lower of cost or market value. Market value is measured based on the value of the collateral securing these loans generally determined based on appraisals by qualified licensed appraisers. If an appraisal is not available, the fair value of the collateral may be determined by using a cash flow analysis, a broker's opinion of value, the net present value of future cash flows, or an observable market price from an active market. Fair value on non-real estate collateral loans is determined using similar methods. In addition, business equipment may be valued by using the net book value from the business financial statements. Impaired loans are evaluated quarterly for impairment. Impaired loans are classified as Level 3 in the fair value hierarchy.

Items measured at fair value on a recurring basis are summarized below:

(in thousands)	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2008
Trading securities	\$	\$	\$	\$

Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

Securities available for sale	474,221	21,119	495,340
Forward contracts	15,666		15,666
Rate lock loan commitments	10,157		10,157
Mortgage loans held for sale	6,758		6,758

Rollforwards of activity for the Company's Significant Unobservable Inputs (Level 3), follows:

Table of ContentsTrading Securities - Residual interest in the RAL securitization

(in thousands)	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2008
Balance, beginning of period	\$ 177	\$
Increase in RAL securitization residual		4,560
Retained securitization residual		102,059
Paydown of securitization residual	(177)	(106,619)
Balance, end of period	\$	\$

Securities available for Sale - Non agency mortgage backed and other non agency mortgage-related securities

(in thousands)	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2008
Balance, beginning of period	\$ 20,554	\$
Transfer into Level 3		22,085
Net unrealized gain	1,968	2,037
Premium amortization	(14)	(47)
Principal paydowns	(1,389)	(2,956)
Balance, end of period	\$ 21,119	\$ 21,119

The Company recorded a realized impairment loss in the Level 3 non agency mortgage backed and other non agency mortgage related securities totaling \$3.9 million and \$3.4 during the third and second quarters of 2008, respectively. The Company recorded a realized impairment loss in the Level 3 non agency mortgage backed and other non agency mortgage related securities totaling \$7.3 million for the nine months ended September 2008. There were no impairment losses recorded in 2007.

Items measured at fair value on a non-recurring basis are summarized below:

(in thousands)	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2008
Impaired loans	\$	\$	\$ 10,663	\$ 10,663

Impaired loans had a carrying amount of \$12.5 million, with a valuation allowance of \$1.9 million, resulting in an additional credit to the provision for loan losses of \$154,000 for the first nine months of 2008.

Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard was effective for the

Table of Contents

Company on January 1, 2008. The Company elected the fair value option for all loans held for sale originated after December 31, 2007.

**7. OFF BALANCE SHEET RISKS, COMMITMENTS AND CONTINGENT LIABILITIES**

Republic is a party to financial instruments with off balance sheet risk in the normal course of business in order to meet the financing needs of its customers. These financial instruments primarily include commitments to extend credit and standby letters of credit. The contract or notional amounts of these instruments reflect the potential future obligations of Republic pursuant to those financial instruments. Creditworthiness for all instruments is evaluated on a case by case basis in accordance with Republic's credit policies. Collateral from the customer may be required based on the Company's credit evaluation of the customer and may include business assets of commercial customers, as well as personal property and real estate of individual customers or guarantors.

Republic also extends binding commitments to customers and prospective customers. Such commitments assure the borrower of financing for a specified period of time at a specified rate. The risk to Republic under such loan commitments is limited by the terms of the contracts. For example, Republic may not be obligated to advance funds if the customer's financial condition deteriorates or if the customer fails to meet specific covenants. An approved but unfunded loan commitment represents a potential credit risk once the funds are advanced to the customer. Unfunded loan commitments also represent liquidity risk since the customer may demand immediate cash that would require funding and interest rate risk as market interest rates may rise above the rate committed. In addition, since a portion of these loan commitments normally expire unused, the total amount of outstanding commitments at any point in time may not require future funding.

As of September 30, 2008, exclusive of Mortgage Banking loan commitments discussed below, Republic had outstanding loan commitments of \$471 million, which included unfunded home equity lines of credit totaling \$330 million. At December 31, 2007, Republic had outstanding loan commitments of \$487 million, which included unfunded home equity lines of credit totaling \$326 million. These commitments generally have variable rates.

Standby letters of credit are conditional commitments issued by Republic to guarantee the performance of a customer to a third party. The terms and risk of loss involved in issuing standby letters of credit are similar to those involved in issuing loan commitments and extending credit. Commitments outstanding under standby letters of credit totaled \$24 million and \$38 million at September 30, 2008 and December 31, 2007.

At September 30, 2008 and December 31, 2007, Republic had a \$12 million letter of credit from the FHLB issued on behalf of one RB&T client. This letter of credit was used as a credit enhancement for a client bond offering and reduced RB&T's available borrowing line at the FHLB. The Company uses a blanket pledge of eligible real estate loans to secure the letter of credit.

On November 5, 2007, the SEC issued Staff Accounting Bulletin (SAB) No. 109, *Written Loan Commitments Recorded at Fair Value through Earnings*. Previously, SAB 105, *Application of Accounting Principles to Loan Commitments*, stated that in measuring the fair value of a derivative loan commitment, a company should not incorporate the expected net future cash flows related to the associated servicing of the loan. SAB 109 supersedes SAB 105 and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in measuring fair value for all written loan commitments that are accounted for at fair value through earnings. SAB 105 also indicated that internally-developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment, and SAB 109 retains that view. The Company also elected to adopt Staff Accounting Bulletin SAB 109 which effectively causes Mortgage Banking revenue to be

recognized on the date the Company enters into the rate lock commitment with the customer.

With the adoption of SAB 109 and SFAS 159 during 2008, the Company recognized \$178,000 in additional Mortgage Banking income related to the Company's mandatory forward sales contracts and rate lock loan commitments.

Mortgage Banking derivatives used in the ordinary course of business consist of mandatory forward sales contracts and rate lock loan commitments. Forward contracts represent future commitments to deliver loans at a specified price and date and are used to manage interest rate risk on loan commitments and mortgage loans held for sale. Rate lock

Table of Contents

commitments represent commitments to fund loans at a specific rate. These derivatives involve underlying items, such as interest rates, and are designed to transfer risk. Substantially all of these instruments expire within 90 days from the date of issuance. Notional amounts are amounts on which calculations and payments are based, but which do not represent credit exposure, as credit exposure is limited to the amounts required to be received or paid. The approximate notional amounts and realized gain/(loss) for Mortgage Banking derivatives recognized in Mortgage Banking income for the period end September 30, 2008 and December 31, 2007 follows:

(in thousands)	September 30, 2008	December 31, 2007
<b>Forward contracts:</b>		
Notional amount	\$ 15,700	\$ 10,700
Gain / (loss) on change in market value of forward contracts	(34)	(41)
<b>Rate lock loan commitments:</b>		
Notional amount	\$ 10,077	\$ 9,635
Gain on change in market value of rate lock commitments	80	24

Forward contracts also contain an element of risk in that the counterparties may be unable to meet the terms of such agreements. In the event the parties to deliver commitments are unable to fulfill their obligations, the Company could potentially incur significant additional costs by replacing the positions at then current market rates. The Company manages its risk of exposure by limiting counterparties to those banks and institutions deemed appropriate by management and the Board of Directors. The Company does not expect any counterparty to default on their obligations and therefore, the Company does not expect to incur any cost related to counterparty default.

The Company is exposed to interest rate risk on loans held for sale and rate lock loan commitments. As market interest rates increase or decrease, the fair value of mortgage loans held for sale and rate lock commitments will decline or increase. To offset this interest rate risk, the Company enters into derivatives such as forward contracts to sell loans. The fair value of these forward contracts will change as market interest rates change, and the change in the value of these instruments is expected to largely, though not entirely, offset the change in fair value of loans held for sale and rate lock commitments. The objective of this activity is to minimize the exposure to losses on rate lock commitments and loans held for sale due to market interest rate fluctuations. The net effect of derivatives on earnings will depend on risk management activities and a variety of other factors, including market interest rate volatility, the amount of rate lock commitments that close, the ability to fill the forward contracts before expiration, and the time period required to close and sell loans.

## 8. EARNINGS PER SHARE

Class A and Class B shares participate equally in undistributed earnings. The difference in earnings per share between the two classes of common stock results solely from the 10% per share cash dividend premium paid on Class A Common Stock over that paid on Class B Common Stock.

A reconciliation of the combined Class A and Class B Common Stock numerators and denominators of the earnings per share and diluted earnings per share computations is presented below:





Table of Contents

(in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income	\$ 4,502	\$ 4,232	\$ 33,048	\$ 18,507
Weighted average shares outstanding	20,591	20,336	20,485	20,516
Effect of dilutive securities	387	281	314	420
Average shares outstanding including dilutive securities	20,978	20,617	20,799	20,936
Basic earnings per share:				
Class A Common Share	\$ 0.22	\$ 0.21	\$ 1.62	\$ 0.91
Class B Common Share	0.21	0.20	1.59	0.88
Diluted earnings per share:				
Class A Common Share	\$ 0.22	\$ 0.21	\$ 1.59	\$ 0.88
Class B Common Share	0.20	0.20	1.56	0.86

Stock options excluded from the detailed earnings per share calculation because their impact was antidilutive are as follows:

Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2008	2007	2008	2007
Antidilutive stock options	10,500	848,359	301,697	376,210

9. SEGMENT INFORMATION



## Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

The reportable segments are determined by the type of products and services offered, distinguished between Banking operations, Mortgage Banking operations and Tax Refund Solutions ( TRS ). Loans, investments and deposits provide the majority of revenue from banking operations; servicing fees and loan sales provide the majority of revenue from mortgage banking operations; RAL fees, ERC fees and Net RAL securitization income provide the majority of the revenue from TRS. The overall earnings of the TRS segment are highly dependent upon the Company's loss estimates for RALs retained on balance sheet and RALs securitized (*for further discussion of these loss estimates see Footnote 3 Loans and Allowance for Loan Losses in this document*). All Company segments are domestic.

The accounting policies used for Republic's reportable segments are the same as those described in the summary of significant accounting policies. Income taxes are allocated based on income before income tax expense. Transactions among reportable segments are made at fair value.

*See the sections titled Business Segment Composition and Results of Operations in Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as Footnote 3 Loans and Allowance for Loans Losses and Footnote 10 Securitization of Part I Item 1 Financial Statements and Part II Item 1A Risk Factors for additional discussion regarding TRS and the securitization.*

Segment information for the three and nine months ended September 30, 2008 and 2007 follows:

Table of Contents

(dollars in thousands)	Three Months Ended September 30, 2008			
	Banking	Tax Refund Solutions	Mortgage Banking	Total Company
Net interest income	\$ 27,520	\$ 229	\$ 97	\$ 27,846
Provision for loan losses	191	133		324
Electronic Refund Check fees		738		738
Net RAL securitization income		157		157
Mortgage banking income			1,071	1,071
Other revenue	1,867	25	(444)	1,448
Total non interest income	1,867	920	627	3,414
Total non interest expenses	21,250	2,574	159	23,983
Gross operating profit	7,946	(1,558)	565	6,953
Income tax expense / (benefit)	2,840	(591)	202	2,451
Net income / (loss)	\$ 5,106	\$ (967)	\$ 363	\$ 4,502
Segment assets	\$ 2,981,809	\$ 56,428	\$ 6,817	\$ 3,045,054
Net interest margin	3.83%	NM	NM	3.86%

(dollars in thousands)	Three Months Ended September 30, 2007			
	Banking	Tax Refund Solutions	Mortgage Banking	Total Company
Net interest income	\$ 21,517	\$ 52	\$ 96	\$ 21,665
Provision for loan losses	1,530	(154)		1,376
Electronic Refund Check fees		77		77
Net RAL securitization income		11		11
Mortgage banking income			905	905
Other revenue	6,689	32	(208)	6,513
Total non interest income	6,689	120	697	7,506
Total non interest expenses	19,436	1,637	205	21,278
Gross operating profit	7,240	(1,311)	588	6,517
Income tax expense / (benefit)	2,467	(387)	205	2,285
Net income / (loss)	\$ 4,773	\$ (924)	\$ 383	\$ 4,232
Segment assets	\$ 3,162,834	\$ 3,570	\$ 4,513	\$ 3,170,917
Net interest margin	2.87%	NM	NM	2.88%

Table of Contents

(dollars in thousands)	Nine Months Ended September 30, 2008			
	Banking	Tax Refund Solutions	Mortgage Banking	Total Company
Net interest income	\$ 81,086	\$ 20,373	\$ 288	\$ 101,747
Provision for loan losses	6,094	8,358		14,452
Electronic Refund Check fees		17,668		17,668
Net RAL securitization income		13,030		13,030
Mortgage banking income			3,806	3,806
Other revenue	11,663	29	(1,302)	10,390
Total non interest income	11,663	30,727	2,504	44,894
Total non interest expenses	63,127	17,545	618	81,290
Gross operating profit	23,528	25,197	2,174	50,899
Income tax expense	8,135	8,966	750	17,851
Net income	\$ 15,393	\$ 16,231	\$ 1,424	\$ 33,048
Segment assets	\$ 2,981,809	\$ 56,428	\$ 6,817	\$ 3,045,054
Net interest margin	3.65%	NM	NM	4.51%

(dollars in thousands)	Nine Months Ended September 30, 2007			
	Banking	Tax Refund Solutions	Mortgage Banking	Total Company
Net interest income	\$ 63,669	\$ 6,948	\$ 306	\$ 70,923
Provision for loan losses	1,910	3,293		5,203
Electronic Refund Check fees		4,189		4,189
Net RAL securitization income		3,713		3,713
Mortgage banking income			2,051	2,051
Other revenue	19,069	138	(712)	18,495
Total non interest income	19,069	8,040	1,339	28,448
Total non interest expenses	60,484	4,635	659	65,778
Gross operating profit	20,344	7,060	986	28,390
Income tax expense	6,877	2,663	343	9,883
Net income	\$ 13,467	\$ 4,397	\$ 643	\$ 18,507
Segment assets	\$ 3,162,834	\$ 3,570	\$ 4,513	\$ 3,170,917
Net interest margin	2.91%	NM	NM	3.21%

---

NM - Not meaningful





Table of Contents

**10. SECURITIZATION**

In January 2006, the Company established TRS RAL Funding, LLC ( TRS RAL, LLC ), a qualified special purpose entity ( QSPE ) and wholly-owned subsidiary corporation of RB&T. The QSPE securitized and sold a portion of the RAL portfolio to an independent third party during the first quarters of 2008 and 2007. The purpose of the securitization was to provide a funding source for the Company's RAL portfolio and also reduce the impact of the RAL program on the Company's regulatory capital.

As part of the securitization, the Company established a two step structure to handle the sale of the assets to third party investors. In the first step, a sale provided for TRS RAL, LLC to purchase the assets from RB&T as Originator and Servicer. In the second step, a sale and administration agreement was entered into by and among TRS RAL, LLC and various other third parties, with TRS RAL, LLC retaining a residual interest in an over-collateralization.

Historically, from mid January to the end of February of each year, RALs which, upon origination, met certain underwriting criteria related to refund amount and Earned Income Tax Credit amount, were classified as loans held for sale and sold into the securitization. All other RALs originated were retained by the Company. There were no RALs held for sale as of any quarter end. The Company retained a related residual value in the securitization, which was classified on the balance sheet as a trading security. The initial residual interest had a weighted average life of approximately one month, and as such, substantially all of its cash flows were received by the end of the first quarter. The disposition of the remaining anticipated cash flows occurred within the remainder of the calendar year. At its initial valuation, and on a quarterly basis thereafter, the Company adjusted the carrying amount of the residual value to its fair value, which was determined based on expected future cash flows and was significantly influenced by the anticipated credit losses of the underlying RALs.

During the first quarters of 2008 and 2007, respectively, the securitization consisted of \$1.1 billion and \$350 million of loans originated and sold. The Company's continuing involvement in loans sold into the securitization was limited to only servicing the RALs. Compensation for servicing the securitized RALs was not contingent upon the performance of the securitized RALs.

The residual value related to the securitization is presented as a trading security on the balance sheet and was \$0 at September 30, 2008 and December 31, 2007. At September 30, 2008, in estimating the Company's residual interest for securitized RALs, the Company estimated that 0.64% of RALs securitized by the Company were uncollectible compared to 0.67% at September 30, 2007. As a result, the Company recorded a net reduction to Net RAL securitization income of \$6.7 million for the first nine months of 2008 and \$2.0 million for the first nine months of 2007.

The Company concluded that the transaction was a sale as defined in SFAS 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125*. This conclusion was based on, among other things, legal isolation of assets, the ability of the purchaser to pledge or sell the assets, and the absence of a right or obligation of the Company to repurchase the financial assets.

Table of Contents

Detail of Net RAL securitization income follows:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net gain on sale of RALs	\$	\$ 5	\$ 8,313	\$ 2,261
Increase in securitization residual		157	4,717	1,452
Net RAL securitization income	\$	\$ 157	\$ 13,030	\$ 3,713

*See the sections titled Business Segment Composition and Results of Operations in Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as Footnote 3 Loans and Allowance for Loans Losses and Footnote 9 Segment Information of Part I Item 1 Financial Statements and Part II Item 1A Risk Factors for additional discussion regarding TRS and the securitization.*

Table of Contents

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

Management's Discussion and Analysis of Financial Condition and Results of Operations of Republic Bancorp, Inc. ( Republic or the Company ) analyzes the major elements of Republic's consolidated balance sheets and statements of income. Republic, a bank holding company headquartered in Louisville, Kentucky, is the Parent Company of Republic Bank & Trust Company, ( RB&T ), Republic Bank (collectively referred together with RB&T as the Bank ), Republic Funding Company and Republic Invest Co. On August 15, 2008, the Company filed applications with the Office of Thrift Supervision to merge Republic Bank & Trust Company, a state chartered commercial bank, and Republic Bank, a federally chartered savings bank, into one federally chartered savings bank. Republic Invest Co. includes its subsidiary, Republic Capital LLC. The consolidated financial statements also include the wholly-owned subsidiaries of RB&T: Republic Financial Services, LLC, TRS RAL Funding, LLC and Republic Insurance Agency, LLC. Republic Bancorp Capital Trust is a Delaware statutory business trust that is a 100%-owned unconsolidated finance subsidiary of Republic Bancorp, Inc. Management's Discussion and Analysis of Financial Condition and Results of Operations of Republic should be read in conjunction with Part I Item 1 *Financial Statements*.

This discussion includes various forward-looking statements with respect to credit quality, including but not limited to, delinquency trends and the adequacy of the allowance for loan losses, business segments, corporate objectives, the Company's interest rate sensitivity model and other financial and business matters. Broadly speaking, forward-looking statements may include:

- projections of revenue, income, losses, earnings per share, capital expenditures, dividends, capital structure or other financial items;
- descriptions of plans or objectives for future operations, products or services;
- forecasts of future economic performance; and
- descriptions of assumptions underlying or relating to any of the foregoing.

The Company may make forward-looking statements discussing management's expectations about various matters, including:

- future credit losses and non-performing assets;
- the adequacy of the allowance for loans losses;
- the anticipated future cash flows of Refund Anticipation Loans ( RALs ); including those securitized and retained on balance sheet;
- Anticipated future funding sources for TRS;
- the future value of mortgage servicing rights;
- the impact of new accounting pronouncements;
- future short-term and long-term interest rate levels and the respective impact on net interest margin, net interest spread, net income, liquidity and capital;
- legal and regulatory matters; and
- future capital expenditures.

**Forward-looking statements discuss matters that are not historical facts. As forward-looking statements discuss future events or conditions, the statements often include words such as anticipate, believe, estimate, expect, intend, plan, project, target, should, will, would, or similar expressions. Do not rely on forward-looking statements. Forward-looking statements detail management's expectations regarding the future and are not guarantees. Forward-looking statements are assumptions based on information known to management only as of the date the statements are made and management may not update them to reflect changes that occur subsequent to the date the statements are made.**

Forward-looking statements discuss matters that are not historical facts. As forward-looking statements discuss future



**Table of Contents**

**OVERVIEW**

Net income for the quarter ended September 30, 2008 was \$4.5 million, representing an increase of \$270,000, or 6%, compared to the same period in 2007. Diluted earnings per Class A Common Share increased 5% to \$0.22 for the quarter ended September 30, 2008 compared to \$0.21 for the same period in 2007.

Net income for the nine months ended September 30, 2008 was \$33.0 million, representing an increase of \$14.5 million, or 79%, compared to the same period in 2007. Diluted earnings per Class A Common Share increased 81% to \$1.59 for the nine months ended September 30, 2008 compared to \$0.88 for the same period in 2007.

General highlights for the third quarter and nine months ended September 30, 2008 consisted of the following:

- Republic ended the quarter with total assets of \$3.0 billion, representing a decline of \$126 million, or 4%, compared to September 30, 2007 and a decline of \$120 million, or 4%, compared to December 31, 2007. The decrease in total assets was primarily the result of a \$79 million decline in loan balances during the year as disciplined pricing measures for the Company's retail portfolio loan products shifted consumer demand to fixed rate loan products, which were sold into the secondary market. In addition, similarly disciplined pricing measures in the commercial lending area, in combination with the Company's traditional underwriting standards and some large maturities during the year, caused a decline in commercial real estate balances.
- Traditional Banking segment net income increased \$333,000, or 7%, and \$1.9 million, or 14%, for the third quarter and nine months ended September 30, 2008 compared to the same periods in 2007. The rise in traditional banking segment net income was primarily attributable to increases in net interest income and non interest income, partially offset by increases in the provision for loan losses, net losses on calls and impairments of securities and non interest expenses.
- For the first nine months of 2008, Tax Refund Solutions ( TRS ) business segment net income increased \$11.8 million, or 269%, compared to the same period in 2007. This increase related primarily to the overall growth in product volume coupled with lower estimated RAL losses as a percent of total originations. Total RAL volume (which occurred primarily in the first quarter and includes RALs sold into the securitization) increased from \$577 million during 2007 to \$1.8 billion during 2008. In addition to the increased RAL volume, Electronic Refund Check ( ERC )/Electronic Refund Deposit ( ERD ) volume increased approximately 309%. The increase in volume was attributable to the new business gained through the Jackson Hewitt contracts previously disclosed, as well as significant growth through the Company's independent tax-preparer customer base. The Company recorded a net loss of \$967,000 for the third quarter of 2008 compared to a net loss of \$924,000 for the same period in 2007. Subsequent to the first quarter of 2008, the results of operations for the TRS segment consist primarily of fixed overhead expenses and adjustments to the segment's estimated residual interest and estimated provision for loan losses, as estimated

results become final.

- Net interest income increased \$6.2 million, or 29%, and \$30.8 million, or 43%, for the third quarter and nine months ended September 30, 2008 compared to the same periods in 2007. The traditional banking segment represented \$6.0 million and \$17.4 million of the increase for the third quarter and nine months ended September 30, 2008 compared to the same periods in 2007. Net interest income within the traditional Banking segment benefited significantly from declining short-term interest rates in combination with an overall steepening of the yield curve, and to a lesser extent, a year-over-year increase in the average balance of the loan portfolio.

- Non interest income declined \$4.1 million, or 55%, for the third quarter of 2008 compared to the same period in 2007 due primarily to \$5.3 million in OTTI charges recorded for one non agency mortgage backed security and the Company's Federal Home Loan Mortgage Corporation ( FHLMC ) preferred stock investment. *See additional discussion regarding these impairment charges under Footnote 2 Securities.* Non interest income for the nine months ended September 30, 2008 increased \$16.5 million, or 58%. Approximately \$22.7 million of the increase was attributable to growth in the Company's tax business at TRS offset which was offset by \$8.9 million of OTTI charges recorded during the first nine months of 2008.

Table of Contents

- The Company's provision for loan losses favorably declined from \$1.4 million during the third quarter of 2007 to \$324,000 during the third quarter of 2008. The Company recorded a provision for loan losses of \$14.5 million for nine months ended September 30, 2008, as compared to \$5.2 million for the same period in 2007.
- The traditional Banking provision for loan losses was \$191,000 during the third quarter of 2008 compared to \$1.5 million during the same period in 2007. The lower estimated provision for loan losses during the quarter was attributable to a favorable decline in loan balances that the Company considers substandard within its allowance calculation. This compares to an unfavorable increase in loan balances that the Company considered substandard during the third quarter of 2007. For the nine months ended September 30, 2008 and 2007, the Banking segment provision for loan losses was \$6.1 million and \$1.9 million. The increase in the bank level provision expense for the nine months ended September 30, 2008 was attributable to the increase in classified, delinquent and non performing loans as well as a \$968,000 adjustment to the allowance calculation during the second quarter of 2008 for qualitative factors generally related to the deteriorating real estate market conditions recorded. For the nine months ended September 30, 2008, approximately \$2.8 million of the increase related to the specific write down of one land development loan in Florida placed on non accrual during the first quarter of 2008.
- For the nine months ended September 30, 2008 and 2007, the TRS segment provision for loan losses was \$8.4 million and \$3.3 million. The year to date increase in estimated losses associated with RALs was primarily due the increased volume detailed above. *For additional discussion regarding the loan loss reserve estimates for TRS, see Footnote 3 Loans and Allowance for Loans Losses of Part I Item 1 Financial Statements.*
- Non interest expenses increased \$2.7 million, or 13%, and \$15.5 million, or 24%, for the third quarter and nine months ended September 30, 2008 compared to the same periods in 2007. Approximately \$937,000 and \$12.9 million of the increases were related to TRS and were driven by the significant year-over-year growth in the program as discussed throughout.

**BUSINESS SEGMENT COMPOSITION**

As of September 30, 2008, the Company was divided into three distinct business operating segments: Banking, Tax Refund Solutions and Mortgage Banking. Net income, total assets and net interest margin by segment for the three and nine month periods ended September 30, 2008 and 2007 are presented below:



Table of Contents

(in thousands)	Three Months Ended September 30, 2008			
	Banking	Tax Refund Solutions	Mortgage Banking	Total Company
Net income / (loss)	\$ 5,106	\$ (967)	\$ 363	\$ 4,502
Segment assets	2,981,809	56,428	6,817	3,045,054
Net interest margin	3.83%	NM	NM	3.86%

(in thousands)	Three Months Ended September 30, 2007			
	Banking	Tax Refund Solutions	Mortgage Banking	Total Company
Net income / (loss)	\$ 4,773	\$ (924)	\$ 383	\$ 4,232
Segment assets	3,162,834	3,570	4,513	3,170,917
Net interest margin	2.87%	NM	NM	2.88%

(in thousands)	Nine Months Ended September 30, 2008			
	Banking	Tax Refund Solutions	Mortgage Banking	Total Company
Net income	\$ 15,393	\$ 16,231	\$ 1,424	\$ 33,048
Segment assets	2,981,809	56,428	6,817	3,045,054
Net interest margin	3.65%	NM	NM	4.51%

(in thousands)	Nine Months Ended September 30, 2007			
	Banking	Tax Refund Solutions	Mortgage Banking	Total Company
Net income (loss)	\$ 13,467	\$ 4,397	\$ 643	\$ 18,507
Segment assets	3,162,834	3,570	4,513	3,170,917
Net interest margin	2.91%	NM	NM	3.21%

**(I) Banking**

Republic has 45 full-service banking centers with 36 located in Kentucky, five in metropolitan Tampa, Florida, three in southern Indiana and one in metropolitan Cincinnati, Ohio. RB&T's primary market areas are located in metropolitan Louisville, central Kentucky, northern Kentucky and southern Indiana. Louisville, the largest city in Kentucky, is the location of Republic's headquarters, as well as 20 banking centers. RB&T's central Kentucky market includes 12 banking centers in the following Kentucky cities: Bowling Green (1); Elizabethtown (1); Frankfort (1); Georgetown (1); Lexington, the second largest city in Kentucky (5); Owensboro (2); and Shelbyville (1). RB&T's northern Kentucky market includes banking centers in Covington, Florence, Fort Wright and Independence. RB&T also has banking centers located in Floyds Knobs, Jeffersonville and New Albany, Indiana. Republic Bank has locations in Hudson, New Port Richey, Palm Harbor, Port Richey, Temple Terrace, Florida, as well as Cincinnati, Ohio. On August 15, 2008, the Company filed applications with the Office of Thrift Supervision to merge Republic Bank & Trust Company, a state chartered commercial bank, and Republic Bank, a federally chartered savings bank, into one federally chartered savings bank.

Banking related operating revenues are derived primarily from interest earned from the Bank's loan and investment securities and fee income from loans, deposits and other banking products. The Bank has historically extended credit and provided



Table of Contents

general banking services through its banking center network to individuals and businesses. The Bank principally markets its banking products and services through the following delivery channels:

**Mortgage Lending** The Bank generally retains adjustable rate residential real estate loans with fixed terms up to ten years. These loans are originated through the Bank's retail banking center network. Fixed rate residential real estate loans that are sold into the secondary market, and their accompanying servicing rights, which may be either sold or retained, are included as a component of the Company's *Mortgage Banking* segment and are discussed below and throughout this document.

**Commercial Lending** Commercial loans are primarily real estate secured and are generated through banking centers in the Bank's market areas. The Bank makes commercial loans to a variety of industries and promotes this business through focused calling programs in order to broaden relationships by providing business customers with loan, deposit and treasury management services.

**Consumer Lending** Traditional consumer loans made by the Bank include home improvement and home equity loans, as well as secured and unsecured personal loans. With the exception of home equity loans, which are actively marketed in conjunction with single family first lien mortgage loans, other traditional consumer loan products are not actively promoted in the Bank's markets.

**Treasury Management Services** The Bank provides various deposit products designed for business customers located throughout its market areas. Lockbox processing, remote deposit capture, business online banking, account reconciliation and Automated Clearing House (ACH) processing are additional services offered to businesses through the Treasury Management Department. The *Premier First* product is the Bank's premium money market sweep account designed for business customers.

**Internet Banking** The Bank expands its market penetration and service delivery by offering customers Internet banking services and products through its website, [www.republicbank.com](http://www.republicbank.com).

**Other Banking Services** The Bank also provides trust, title insurance and other financial institution related products and services.

**(II) Tax Refund Solutions ( TRS )**

## Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

RB&T, through its TRS business segment, is one of a limited number of financial institutions which facilitates the payment of federal and state tax refunds through third party tax-preparers located throughout the U.S. Substantially all of the business generated by TRS occurs in the first quarter of the year. The Company facilitates the payment of these tax refunds through three primary products: RALs, ERCs and ERDs.

ERCs/ERDs are products whereby a tax refund is issued to the taxpayer after RB&T has received the refund from the federal or state government. There is no credit risk or borrowing cost for the Company because ERCs/ERDs are only delivered to the taxpayer upon receipt of the refund directly from the Internal Revenue Service ( IRS ). Fees earned on ERCs/ERDs are reported as non interest income under the line item Electronic refund check fees.

RALs are short-term consumer loans offered to taxpayers, secured by their anticipated tax refund, which represents the source of repayment. The Company underwrites the RAL application through an automated credit review process utilizing information contained with the taxpayer s tax return. If the application is approved, the Company advances the amount of the refund due on the taxpayer s return up to specified amounts less the loan fee due to the Company and, if requested by the taxpayer, the fees due for preparation of the return to the tax preparer. As part of the RAL application process, each taxpayer signs an agreement directing the IRS to send the taxpayer s refund directly to the Company. The refund received from the IRS is used by the Company to pay off the RAL. Any amount due the taxpayer above the amount of the RAL is remitted to the taxpayer once the refund is received by the Company. The funds advanced by the Company are generally repaid by the IRS within two weeks. The fees earned on RALs retained on balance sheet are reported as interest income under the line item Loans, including fees.

While the loan application form is completed by the taxpayer in the tax preparer s office, the credit criteria is established by the Company and the underwriting decision is made by the Company. The Company reviews and evaluates all tax returns to

Table of Contents

determine the likelihood of IRS payment. If any attribute of the tax return appears to fall outside of predetermined parameters, the Company will not originate the RAL.

Substantially all RALs issued by the Company each year are made during the first quarter. Losses associated with RALs result from the IRS not remitting taxpayer refunds to the Company associated with a particular tax return. This occurs for a number of reasons, including errors in the tax return and tax return fraud. At March 31st of each year, with adjustments each quarter end thereafter, the Company reserves for its estimated RAL losses based on current year and historical funding patterns and information received from the IRS regarding current year payment processing. The Company applies its loss estimates to both RALs retained on balance sheet and to securitized RALs. The Company applies loss estimates to securitized RALs because the securitization residual is valued based on the future expected cash flows of the securitization, which is significantly influenced by the anticipated credit losses of the underlying RALs. Estimated losses related to securitized RALs are recorded in non interest income as a reduction to Net RAL securitization income.

The overall earnings of the TRS segment are highly dependent upon the Company's loss estimates for RALs retained on balance sheet and securitized RALs. The Company believes that based on information currently available, it has provided the appropriate amount of reserves for losses associated with RALs. At September 30, 2008, the Company had effectively fully reserved for all uncollected RALs, both securitized and retained on balance sheet. The possibility remains, however, that additional payments could be received from the IRS during the fourth quarter of 2008 resulting in an adjustment to the Company's previous allowance for loan losses and residual interest, or trading security. The Company believes that any payments received from the IRS during the fourth quarter of 2008 will be immaterial and recorded as an adjustment to income if received.

Subsequent to the first quarter of 2008, the results of operations for the TRS segment consist primarily of fixed overhead expenses and adjustments to the segment's estimated residual interest and estimated provision for loan losses as estimated results become final.

**TRS Funding**

Historically, from mid January to the end of February of each year, RALs which, upon origination, met certain underwriting criteria related to refund amount and Earned Income Tax Credit amount, were classified as loans held for sale and sold into the securitization. All other RALs originated were retained by the Company. There were no RALs held for sale as of any quarter end. The Company retained a related residual value in the securitization, which was classified on the balance sheet as a trading security. The initial residual interest had a weighted average life of approximately one month, and as such, substantially all of its cash flows were received by the end of the first quarter. The disposition of the remaining anticipated cash flows occurred within the remainder of the calendar year. At its initial valuation, and on a quarterly basis thereafter, the Company adjusted the carrying amount of the residual value to its fair value, which was determined based on expected future cash flows and was significantly influenced by the anticipated credit losses of the underlying RALs.

During the first quarters of 2008 and 2007, respectively, the securitization consisted of a total of \$1.1 billion and \$350 million of RALs originated and sold. The Company's continuing involvement in RALs sold into the securitization was limited to only servicing of the RALs. Compensation for servicing of the RALs securitized was not contingent upon performance of the RALs securitized.

## Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

The Company concluded that the transaction was a sale as defined in SFAS 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125*. This conclusion was based on, among other things, legal isolation of assets, the ability of the purchaser to pledge or sell the assets, and the absence of a right or obligation of the Company to repurchase the financial assets.

In addition to the securitization structure, the Company also utilized brokered deposits to fund RALs retained on balance sheet. During the fourth quarter of 2007, the Company obtained \$272 million in brokered deposits to be utilized to fund the RAL program. These brokered deposits had a life of three months with a weighted average rate of 5.09%. Also, during January of 2008, the Company obtained an additional \$200 million in brokered deposits to fund additional RAL demand. These brokered deposits had a three month life and a weighted average rate of 4.95%.

At the time of this filing, the Company has not finalized its funding strategy for the upcoming first quarter 2009 tax season. At this time, management believes it will be able to obtain all of the funding it needs for the upcoming tax season. Similar to the

Table of Contents

first quarter of 2008, management is considering funding options, which include a combination of brokered deposits and a securitization structure. In addition, the Company is also in discussion with two large national banks for a significant on-balance sheet line of credit facility secured by RALs. Because of the significant lack of liquidity currently in the credit markets, the Company may not be able to obtain its necessary funding from a securitization structure or from the line of credit facilities with terms acceptable to the Company. If the Company cannot obtain its necessary funding from the securitization structure and/or the line of credit facilities, the Company will rely on other sources of funding such as brokered deposits and other lines of credit and may need to draw on holding company lines of credit to provide additional capital to the Bank. Regardless of the final decision related to the securitization and the on-balance sheet line of credit facilities, the Company will likely begin to increase its brokered deposit balances significantly during the fourth quarter of 2008 in anticipation of the upcoming funding needs for the tax season.

*See the section titled Results of Operations in Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as Footnote 3 Loans and Allowance for Loans Losses, Footnote 9 Segment Information and Footnote 10 Securitization of Part I Item 1 Financial Statements and Part II Item 1A Risk Factors for additional discussion regarding TRS and the securitization.*

**(III) Mortgage Banking**

Mortgage Banking activities primarily include 15, 20 and 30-year fixed rate real estate loans that are sold into the secondary market. Since 2003, the Bank has historically retained servicing on substantially all loans sold into the secondary market. Administration of loans with the servicing retained by the Bank includes collecting principal and interest payments, escrowing funds for taxes and insurance and remitting payments to the secondary market investors. A fee is received by the Bank for performing these standard servicing functions.

*See additional detail regarding Mortgage Banking under Footnote 9 Segment Information of Item 1 Financial Statements.*

**RESULTS OF OPERATIONS**

**Tax Refund Solutions ( TRS )**

The total volume of tax return refunds processed during the 2008 tax season increased \$3.9 billion, or 269%, over the same period in 2007. The Company originated \$1.8 billion in RALs during 2008 compared to \$577 million for the same period in 2007. Total ERC/ERD volume was \$3.6 billion during 2008 compared to \$873 million for the same period in 2007. The substantial growth at TRS primarily resulted from successful sales efforts to independent tax preparers and the previously disclosed Jackson Hewitt contracts signed in the latter half of 2007. These new contract opportunities became available to Republic with the announced exiting of the business in early 2007 by a large competitor of Republic.

For the past three years, the Company implemented a RAL securitization to provide an alternative liquidity vehicle to supplement brokered deposits. In addition to providing an additional funding source, the purpose of the securitization was to reduce the impact to regulatory capital of the RAL portfolio, helping ensure the Company was able to maintain well-capitalized status. Approximately \$1.1 billion and \$350 million in

## Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

RALs were sold through the securitization during the first quarters of 2008 and 2007, respectively. The Company used brokered deposits and overnight borrowing lines to fund the RALs that were retained on-balance sheet.

During 2008, TRS earned \$19.5 million in net RAL fee income, compared to \$6.0 million for the same period in 2007. TRS also earned \$17.7 million in net ERC/ ERD revenue during 2008 compared to \$4.2 million for the same period in 2007. Net RAL securitization income increased \$9.3 million, or 251%, to \$13.0 million as of September 30, 2008 compared to \$3.7 million for the same period in 2007. All of these increases were attributed to an increase in volume detailed throughout this document.

Total tax refund volume for 2008 increased 269% over 2007. Overall segment net income increased \$11.8 million, or 269%, compared to the same period due to the increase in volume discussed above, as well as lower estimated losses, lower confirmed fraud losses and a decline in the amount of refunds held by the IRS for reasons such as audits and liens from prior debts offset by the increase in non interest expenses.



Table of Contents

Substantially all RALs issued by the Company each year are made during the first quarter. Losses associated with RALs result from the IRS not remitting taxpayer refunds to the Company associated with a particular tax return. This occurs for a number of reasons, including errors in the tax return and tax return fraud. At March 31st of each year, with adjustments each quarter end thereafter, the Company reserves for its estimated RAL losses based on current year and historical funding patterns and information received from the IRS regarding current year payment processing. The Company applies its loss estimates to both RALs retained on balance sheet and to securitized RALs. The Company applies loss estimates to securitized RALs because the securitization residual is valued based on the future expected cash flows of the securitization, which is significantly influenced by the anticipated credit losses of the underlying RALs. Estimated losses related to securitized RALs are recorded in non interest income as a reduction to Net RAL securitization income.

The overall earnings of the TRS segment are highly dependent upon the Company's loss estimates for RALs retained on balance sheet and securitized RALs. The Company believes that based on information currently available, it has provided the appropriate amount of reserves for losses associated with RALs. At September 30, 2008, the Company had effectively fully reserved for all uncollected RALs, both securitized and retained on balance sheet. The possibility remains, however, that additional payments could be received from the IRS during the fourth quarter of 2008 resulting in an adjustment to the Company's previous allowance for loan losses and residual interest, or trading security. The Company believes that any payments received from the IRS during the fourth quarter of 2008 will be immaterial and recorded as an adjustment to income if received.

Subsequent to the first quarter of 2008, the results of operations for the TRS segment consist primarily of fixed overhead expenses and adjustments to the segment's estimated residual interest and estimated provision for loan losses as actual results become final.

Detail of Net RAL securitization income follows:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net gain on sale of RALs	\$	\$ 5	\$ 8,313	\$ 2,261
Increase in securitization residual		157	4,717	1,452
Net RAL securitization income	\$	\$ 157	\$ 13,030	\$ 3,713

See the section titled *Business Segment Composition* in Part I Item 2 *Management's Discussion and Analysis of Financial Condition and Results of Operations*, as well as Footnote 3 *Loans and Allowance for Loan Losses*, Footnote 9 *Segment Information* and Footnote 10 *Securitization* of Part I Item 1 *Financial Statements* and Part II Item 1A *Risk Factors* for additional discussion regarding TRS and the securitization.

**Net Interest Income**

**The largest source of Republic's revenue is net interest income. Net interest income is the difference between interest income on interest-earning assets, such as loans and securities and the interest expense on liabilities used to fund those assets, such as interest-bearing deposits and borrowings. Net interest income is impacted by both changes in the amount and composition of interest-earning assets and interest-bearing liabilities, as well as market interest rates.**

For the third quarter of 2008, net interest income was \$27.8 million, an increase of \$6.2 million, or 29%, over the third quarter of 2007. The Company experienced a \$6.0 million, or 28%, increase in net interest income within the traditional Banking segment primarily related to a significant reduction in the Company's cost of funds resulting from declining short-term interest rates in combination with an overall steepening of the yield curve.

As illustrated in Table 3, for the third quarter of 2008 compared to 2007, the Company was able to increase its net interest income primarily through the decline in rates on deposits and borrowings which repriced with short-term indices. For the third quarter of 2008, the Company's net interest spread improved 115 basis points over the third quarter of 2007 while net interest margin improved 98 basis points for the same period.

Table of Contents

For the first nine months of 2008, net interest income was \$101.7 million, an increase of \$30.8 million, or 43%, over the same period in 2007. The previously discussed growth in RAL volume was a significant factor in the Company's increase in net interest income, as TRS net interest income increased \$13.4 million. The traditional Banking segment also realized a \$17.4 million, or 27%, increase over the first nine months of 2007. As with the third quarter, the Banking segment also benefited from declining short-term interest rates in combination with an overall steepening of the yield curve.

The Company's net interest spread increased 144 basis points to 4.02% for nine months ended September 30, 2008 compared to the same period in 2007. The Company's net interest margin increased 130 basis points to 4.51% for the same period. As previously discussed, the increase was tied to the increased RAL volume, as well as recent decreases in the Federal Funds Target rate. From September 2007 through the end of the year, the Federal Open Markets Committee (FOMC) of the Federal Reserve Bank (FRB) lowered the Federal Funds Target rate by 100 basis points. During the first and second quarters of 2008, the FOMC dropped rates another 200 basis points and 25 basis points, respectively, ending the period with a Federal Funds Target rate at 2.00%. There were no Federal Funds Target changes during the third quarter of 2008. The Federal Funds Target rate is an index which many of the Company's short-term deposit rates track. Because the Company's interest bearing liabilities continue to be more sensitive to interest rate movements than its assets, the decreases in the Federal Funds Target rate have significantly benefited the Company's net interest income and net interest margin since the fourth quarter of 2007.

The Company believes that any further rate reductions of the Federal Funds Target rate by the FOMC, such as the 50 basis point reduction that occurred in October 2008, will continue to benefit the Company's net interest income and net interest margin in the short-term. Management believes, however, that the positive impact to earnings from future rate reductions will likely not be as great as those experienced by Republic in the past due to the inability of the Company to further reduce deposit costs as market rates approach, and/or reach, zero percent. In addition, the general lack of liquidity in the wholesale markets has caused a large part of the Company's incremental funding costs to increase—a trend that has begun to offset some of the positive impact to the Company's net interest margin it has received from declining short-term rates. The Company will also continue to experience paydowns in its loan and investment portfolios. These paydowns have caused, and will continue to cause, compression in Republic's net interest income and net interest margin, as the cash received from these paydowns will likely be reinvested at lower yields. Any increases in the Federal Funds Target Rate will cause compression to the Company's net interest income and net interest margin.

The Company is unable to precisely determine the ultimate impact to the Company's net interest spread and margin in the future resulting from FOMC rate changes because of factors unknown at this time such as future demand for the Company's financial products and its overall future need for liquidity, among many other factors.

*For additional information on the potential future effect of changes in short-term interest rates on Republic's net interest income, see section titled Interest Rate Sensitivity in this section of the document. For additional discussion regarding the securitization, see the section titled Tax Refund Solutions in this section of the document and Footnote 9 Segment Information and Footnote 10 Securitization of Item 1 Financial Statements.*

Table 1 and Table 2 provide detailed information as to average balances, interest income/expense and rates by major balance sheet category for the three and nine month periods ended September 30, 2008 and 2007. Table 3 provides an analysis of the changes in net interest income attributable to changes in rates and changes in volume of interest-earning assets and interest-bearing liabilities.



Table of Contents**Table 1 Average Balance Sheets and Interest Rates for the Three Months Ended September 30, 2008 and 2007**

(dollars in thousands)	Three Months Ended September 30, 2008			Three Months Ended September 30, 2007		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>ASSETS</b>						
<b>Earning assets:</b>						
Taxable investment securities(1)	\$ 536,439	\$ 6,484	4.83%	\$ 626,929	\$ 8,199	5.23%
Tax exempt investment securities(4)	1,831	6	2.02	1,783	23	7.94
Federal funds sold and other	7,723	57	2.95	8,247	109	5.29
Loans and fees(2)(3)	2,340,007	37,380	6.39	2,372,182	40,702	6.86
Total earning assets	2,886,000	43,927	6.09	3,009,141	49,033	6.52
Less: Allowance for loan losses	16,236			11,430		
<b>Non-earning assets:</b>						
Cash and cash equivalents	55,976			58,034		
Premises and equipment, net	41,307			37,615		
Other assets(1)	43,164			41,648		
Total assets	\$ 3,010,211			\$ 3,135,008		
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>						
<b>Interest-bearing liabilities:</b>						
Transaction accounts	\$ 231,720	\$ 198	0.34%	\$ 223,405	\$ 441	0.79%
Money market accounts	596,011	2,486	1.67	652,658	7,049	4.32
Time deposits	455,146	4,189	3.68	476,528	5,445	4.57
Brokered deposits	130,827	1,058	3.23	104,392	1,322	5.07
Total deposits	1,413,704	7,931	2.24	1,456,983	14,257	3.91
Repurchase agreements and other short-term borrowings	352,498	1,439	1.63	423,694	4,799	4.53
Federal Home Loan Bank advances	622,011	6,077	3.91	664,279	7,678	4.62
Subordinated note	41,240	634	6.15	41,240	634	6.15
Total interest-bearing liabilities	2,429,453	16,081	2.65	2,586,196	27,368	4.23
<b>Non-interest-bearing liabilities and stockholders equity:</b>						
Non-interest-bearing deposits	279,061			278,836		
Other liabilities	29,197			28,256		
Stockholders equity	272,500			241,720		
Total liabilities and stockholders equity	\$ 3,010,211			\$ 3,135,008		
Net interest income		\$ 27,846			\$ 21,665	
Net interest spread			3.44%			2.29%
Net interest margin			3.86%			2.88%

- (1) *For the purpose of this calculation, the fair market value adjustment on investment securities resulting from SFAS 115, Accounting for Certain Investments in Debt and Equity Securities is included as a component of other assets.*
- (2) *The amount of loan fee income included in total interest income was \$1.3 million and \$980,000 for the three months ended September 30, 2008 and 2007.*
- (3) *Average balances for loans include the principal balance of non accrual loans.*
- (4) *Yields on tax exempt securities have been computed based on a fully tax-equivalent basis using the federal income tax rate of 35%.*

Table of Contents**Table 2 Average Balance Sheets and Interest Rates for the Nine Months Ended September 30, 2008 and 2007**

(dollars in thousands)	Nine Months Ended September 30, 2008			Nine Months Ended September 30, 2007		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>ASSETS</b>						
<b>Earning assets:</b>						
Taxable investment securities(1)	\$ 573,073	\$ 22,352	5.20%	\$ 595,600	\$ 23,304	5.22%
Tax exempt investment securities(4)	1,813	51	5.77	1,783	76	8.74
Federal funds sold and other	44,850	1,035	3.08	7,897	311	5.25
Loans and fees(2)(3)	2,387,926	133,922	7.48	2,344,320	125,701	7.15
Total earning assets	3,007,662	157,360	6.98	2,949,600	149,392	6.75
Less: Allowance for loan losses	15,959			11,834		
<b>Non-earning assets:</b>						
Cash and cash equivalents	81,608			57,201		
Premises and equipment, net	40,359			36,327		
Other assets(1)	38,862			39,947		
Total assets	\$ 3,152,532			\$ 3,071,241		
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>						
<b>Interest-bearing liabilities:</b>						
Transaction accounts	\$ 231,388	\$ 702	0.40%	\$ 223,627	\$ 1,206	0.72%
Money market accounts	600,825	9,029	2.00	572,745	18,169	4.23
Time deposits	442,581	13,242	3.99	488,777	16,219	4.42
Brokered deposits	209,946	7,268	4.62	124,339	4,660	5.00
Total deposits	1,484,740	30,241	2.72	1,409,488	40,254	3.81
Repurchase agreements and other short-term borrowings	373,655	5,622	2.01	435,019	14,942	4.58
Federal Home Loan Bank advances	605,914	17,862	3.93	625,380	21,392	4.56
Subordinated note	41,240	1,888	6.10	41,240	1,881	6.08
Total interest-bearing liabilities	2,505,549	55,613	2.96	2,511,127	78,469	4.17
<b>Non-interest-bearing liabilities and stockholders equity:</b>						
Non-interest-bearing deposits	338,569			291,142		
Other liabilities	43,890			27,062		
Stockholders equity	264,524			241,910		
Total liabilities and stockholders equity	\$ 3,152,532			\$ 3,071,241		
Net interest income		\$ 101,747			\$ 70,923	
Net interest spread			4.02%			2.58%
Net interest margin			4.51%			3.21%

- (1) *For the purpose of this calculation, the fair market value adjustment on investment securities resulting from SFAS 115, Accounting for Certain Investments in Debt and Equity Securities is included as a component of other assets.*
- (2) *The amount of loan fee income included in total interest income was \$23.0 million and \$9.0 million for the nine months ended September 30, 2008 and 2007.*
- (3) *Average balances for loans include the principal balance of non accrual loans.*
- (4) *Yields on tax exempt securities have been computed based on a fully tax-equivalent basis using the federal income tax rate of 35%.*



Table of Contents

Table 3 illustrates the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities impacted Republic's interest income and interest expense during the periods indicated. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior rate), (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume) and (iii) net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

**Table 3 Volume/Rate Variance Analysis**

(in thousands)	Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007 Increase/(Decrease) Due to			Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007 Increase/(Decrease) Due to		
	Total Net Change	Volume	Rate	Total Net Change	Volume	Rate
<b>Interest income:</b>						
Taxable investment securities	\$ (1,714)	\$ (1,124)	\$ (590)	\$ (952)	\$ (879)	\$ (73)
Tax exempt investment securities	(17)	1	(18)	(25)	2	(27)
Federal funds sold and other	(53)	(7)	(46)	724	902	(178)
Loans and fees	(3,322)	(403)	(2,919)	8,221	14,565	(6,344)
Net change in interest income	(5,106)	(1,533)	(3,573)	7,968	14,590	(6,622)
<b>Interest expense:</b>						
Transaction accounts	(243)	16	(259)	(504)	41	(545)
Money market accounts	(4,562)	(564)	(3,998)	(9,140)	851	(9,991)
Time deposits	(1,257)	(236)	(1,021)	(2,977)	(1,459)	(1,518)
Brokered deposits	(264)	285	(549)	2,608	2,988	(380)
Repurchase agreements and other short-term borrowings	(3,360)	(699)	(2,661)	(9,320)	(1,870)	(7,450)
Federal Home Loan Bank advances	(1,601)	(466)	(1,135)	(3,530)	(649)	(2,881)
Subordinated note				7		7
Net change in interest expense	(11,287)	(1,664)	(9,623)	(22,856)	(98)	(22,758)
Net change in net interest income	\$ 6,181	\$ 131	\$ 6,050	\$ 30,824	\$ 14,688	\$ 16,136

Table of Contents

**Non interest Income**

Non interest income declined \$4.1 million, or 55%, for the third quarter of 2008 compared to the third quarter of 2007. For the first nine months of 2008, non interest income increased \$16.4 million, or 58%, compared to the same period in 2007.

Service charges on deposit accounts increased \$247,000, or 5%, for the third quarter of 2008 and \$915,000, or 7%, for the first nine months of 2008, as compared to the same periods in 2007. The increase for both the quarter and nine months was primarily due to growth in the Company's checking account base in conjunction with growth in the Bank's Overdraft Honor program, which permits selected customers to overdraft their accounts up to a predetermined dollar amount (up to a maximum of \$1,000) for the Bank's customary overdraft fee. The Company also increased its overdraft fee by 7% in April of 2008. Included in service charges on deposits are net per item net overdraft fees of \$3.6 million for the third quarters of 2008 and 2007 and \$10.3 million and \$10.1 million for the first nine months of 2008 and 2007.

For the first nine months of 2008, Electronic refund check (ERC) fees and Net RAL securitization income increased \$13.5 million and \$9.3 million, respectively. The increase was attributable to the overall increase in volume at TRS during the tax season in combination with a lower estimated loss rate on underlying securitized RALs. The potential exists during the remainder of the year that the Company will further revise its estimate for future cash flows of the residual interest of the securitization based on the collectibility of the underlying securitized RALs. The Company believes the impact of these changes in estimate will be immaterial to the financial statements and will recognize any changes in subsequent quarters as they are realized.

*See the sections titled Business Segment Composition and Results of Operations in Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as Footnote 3 Loans and Allowance for Loans Losses, Footnote 9 Segment Information and Footnote 10 Securitization of Part I Item 1 Financial Statements and Part II Item 1A Risk Factors for additional discussion regarding TRS and the securitization.*

Mortgage Banking income increased \$1.8 million during the nine months ended September 30, 2008 compared to the same period in 2007. The rise in mortgage banking income was primarily due to an increase in net gain on sale of loans, which resulted from a slight increase in the volume of loans sold in combination with an increase in the value of the servicing component assigned by the Company for loans sold servicing retained during the period. In addition, during the first nine months of 2008, the Company charged higher closing costs to its clients for fixed rate secondary market products and recognized a \$178,000 gain related to the adoption of SAB 109 *Written Loan Commitments Recorded at Fair Value Through Earnings* and SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*.

The Company recognized a net loss on sales, calls and impairment of securities of \$8.9 million during the first nine months of 2008, primarily as a result of OTTI charges recorded for three non agency mortgage backed and other non agency mortgage-related securities and the Company's FHLMC preferred stock investment. Approximately \$5.3 million of the impairment charge was recognized during the third quarter of 2008. *See additional discussion under the section titled Investment Securities in this section of the document, as well as Footnote 2 Securities of Item 1 Financial Statements.*

**Non interest Expenses**

Non interest expenses increased \$2.7 million, or 13%, for the quarter ended September 30, 2008 compared to the same period in 2007 due primarily to an increase in salaries and employee benefits combined with higher other expenses. Non interest expenses increased \$15.5 million, or 24%, during the first nine months of 2008 compared to the same period in 2007, due primarily to the same reasons.

Approximately \$937,000 of the third quarter increase was related to TRS and was driven by the significant year-over-year growth in the program and infrastructure. Within the Company's traditional Banking segment, non interest expenses increased \$1.8 million, or 9%, for the third quarter of 2008 compared to 2007.

- With respect to third quarter increase in non interest expense at TRS:

Table of Contents

- TRS salaries and employee benefits increased \$744,000 consistent with annual merit increases, increased staffing, including seasonal contract labor staffing, and increased incentive compensation accruals.
- TRS occupancy and equipment expense increased \$223,000 primarily due to higher leased and rented equipment and facility rent expense, as the Company expanded its infrastructure to accommodate an increase in volume.
- With respect to the third quarter change in non interest expense associated with the Company's traditional Banking segment:
  - Salaries and employee benefits increased \$814,000 due primarily to an increase in staffing associated with new banking center openings and higher costs associated with the Company's health insurance.
  - Occupancy and equipment increased \$192,000 primarily due to growth in the Company's infrastructure and banking center network, as well as increased leasing costs and service agreements for the Company's technology and operating systems.
  - Other expense increased \$774,000. The increase in other expense was spread among several categories and includes increases for FDIC deposit insurance, contribution expenses, routine audit and professional fees, reimbursement of foreign ATM fees for the Company's BreakFree and Ultimate checking account clients and correspondent banking fees.

Approximately \$12.9 million of the year to date increase was related to TRS and was also driven by the significant year-over-year growth in the program and infrastructure. Within the Company's traditional Banking segment, non interest expenses increased \$2.6 million, or 4% for the nine months ended September 30, 2008.

- With respect to the year to date increase in non interest expense at TRS:
  - TRS salaries and employee benefits increased \$3.9 million consistent with annual merit increases, increased staffing, including seasonal contract labor staffing, and increased incentive compensation accruals.

- TRS occupancy and equipment expense increased \$837,000 primarily due to higher leased and rented equipment and facility rent expense, as the Company expanded its infrastructure to accommodate the anticipated increase in volume.
- TRS marketing and development expense increased \$6.0 million due to expenses associated with the Program and Technology Agreements related to the Jackson Hewitt relationship.
- TRS telephone and postage expense increased \$262,000 consistent with the overall growth in the program.
- TRS office supplies increased \$117,000 consistent with the overall growth in the program and increased printed materials.
- Other expenses at TRS increased \$1.7 million primarily due to expenses such as routine professional fees, fraud detection and identification verification, and correspondent banking relationships. Included in professional fees is the annual review of the RAL underwriting by a third party consultant and routine annual audits of tax preparation offices nationwide.
- With respect to the year to date change in non interest expense associated with the Company's traditional Banking segment:
  - Salaries and employee benefits increased \$1.1 million due primarily to an increase in staffing associated with new banking center openings and higher costs associated with the Company's health insurance.

Table of Contents

- Occupancy and equipment increased \$666,000 primarily due to growth in the Company's infrastructure and banking center network, as well as increased leasing costs and service agreements for the Company's technology and operating systems.
- Other expense increased \$957,000. Consistent with the third quarter, this increase in other expense was spread among several categories and includes increases for FDIC deposit insurance, contribution expenses, routine audit and professional fees, reimbursement of foreign ATM fees for the Company's BreakFree and Ultimate checking account clients and correspondent banking fees.

**COMPARISON OF FINANCIAL CONDITION AT SEPTEMBER 30, 2008 AND DECEMBER 31, 2007**

**Investment Securities**

Securities available for sale primarily consists of U.S. Treasury and U.S. Government Agency obligations, including agency mortgage backed securities ( MBSs ), agency collateralized mortgage obligations ( CMOs ), non agency mortgage backed and other non agency mortgage-related securities and FHLMC preferred stock. The agency MBSs primarily consist of hybrid mortgage securities, as well as other adjustable rate mortgage securities, underwritten and guaranteed by Ginnie Mae ( GNMA ), FHLMC and Fannie Mae ( FNMA ). Agency CMOs held in the investment portfolio are substantially all floating rate securities that adjust monthly. The Company primarily uses the securities portfolio as collateral for securities sold under agreements to repurchase ( repurchase agreements ) and to mitigate the Company's risk position from rising interest rates. Strategies for the securities portfolio may also be influenced by economic and market conditions, loan demand, deposit mix and liquidity needs.

During the first nine months of 2008, Republic purchased \$1.89 billion in securities and had maturities and calls of \$1.92 billion. Substantially all of the securities purchased were agency discount notes, which the Company utilized primarily for collateral purposes. The weighted average yield on these discount notes was 2.70% with an average term of 2 days. Substantially all of the cash received from the maturities and calls of the investment securities that was not reinvested into discount notes was utilized to pay down advances from the Federal Home Loan Bank.

The Company recognized a net loss on impairment of securities of \$8.9 million during the first nine months of 2008, as three non agency mortgage backed and other non agency mortgage-related securities and the Company's FHLMC preferred stock investment were deemed to be other-than-temporarily impaired by the Company. Approximately \$5.3 million of the impairment charge was recognized during the third quarter of 2008. *See additional discussion under Footnote 2 Securities of Item 1 Financial Statements.*

**Loan Portfolio**

## Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

Net loans, primarily consisting of secured real estate loans, decreased by \$80 million during the first nine months of 2008 to \$2.3 billion at September 30, 2008. While commercial and home equity loans increased \$11 million and \$20 million during the first nine months of 2008, the Company experienced a decline of \$50 million, \$9 million and \$46 million in the residential real estate, commercial real estate and real estate construction loan portfolios, respectively. Generally, the overall decline was due to higher pricing requirements implemented by the Company which effectively shifted 1-4 family real estate loan volume into secondary market products or to other financial institutions with lower offering rates. In addition, the Company implemented stricter underwriting standards due to the deterioration in the real estate markets which, in combination with higher pricing strategies, caused portfolio level origination volume to decrease significantly during the first nine months of 2008. The Company currently expects to maintain these pricing and underwriting strategies through the remainder of 2008 and, as a result, the Company anticipates a continued decline in loan balances throughout the remainder of the year.

Within the real estate loan construction category, the Company substantially exited a relationship during the first quarter in which it originated construction loans on a national basis through a building material supplier. In addition to being secured by the underlying collateral, these loans contained a guarantee from a related party of the building material supplier. The Company chose to exit this relationship due to the economic uncertainty in the national residential real estate market. Exiting this relationship resulted in a reduction of approximately \$21 million with the real estate loan construction category.

Table of Contents

**Allowance for Loan Losses and Provision for Loan Losses**

The allowance for loan losses as a percent of total loans increased to 0.61% at September 30, 2008 compared to 0.53% at December 31, 2007. In general, the increase in the allowance for loan losses as a percentage of total loans was primarily attributable to additional reserves recorded based on the increase in past due, non-performing and classified loans. The Company believes, based on information presently available, that it has adequately provided for loan losses at September 30, 2008.

The Company recorded a provision for loan losses of \$14.5 million for the nine months ended September 30, 2008, compared to a provision of \$5.2 million for the same period in 2007. Included in the provision for loan losses for 2008 and 2007 was \$8.4 million and \$3.3 million for net estimated losses associated with RALs retained on balance sheet. The increase in estimated losses associated with RALs was primarily due the increased volume offset by lower confirmed fraud and a decline in the amount of refunds held by the IRS for reasons such as audits and liens from prior debts.

The Banking segment provision for loan losses was \$6.1 million for the nine months ended September 30, 2008 compared to \$1.9 million or the same period in 2007. In general, the increase in the allowance for loan losses was primarily attributable to reserves required for the increase in classified, delinquent and non-performing loans and a \$968,000 adjustment recorded in the second quarter of 2008 related to several qualitative factors within the allowance calculation due to the generally deteriorating real estate market conditions. Approximately \$2.8 million of the increase was related to one land development loan in Florida placed on non accrual during the first quarter of 2008. This \$4.7 million loan is currently in process of foreclosure.

The Company recorded a provision for loan losses of \$324,000 for the third quarter 2008, compared to a provision of \$1.4 million for the same period in 2007. Included in the provision for loan losses for 2008 was \$133,000 for net estimated losses associated with RALs retained on-balance sheet compared to a credit of \$154,000 for the same period in 2007. The Banking segment provision for loan losses was \$191,000 for the third quarter of 2008 compared to \$1.5 million for the same period in 2007. The lower estimated provision for loan losses during the quarter was attributable to a favorable decline in loan balances that the Company considers substandard within its allowance calculation. This compares to an unfavorable increase in loan balances that the Company considered substandard during the third quarter of 2007.

*See the sections titled Business Segment Composition and Results of Operations in Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as Footnote 3 Loans and Allowance for Loans Losses, Footnote 9 Segment Information and Footnote 10 Securitization of Part I Item 1 Financial Statements and Part II Item 1A Risk Factors for additional discussion regarding TRS and the securitization.*



Table of Contents

An analysis of the changes in the allowance for loan losses and selected ratios follows:

**Table 4 Summary of Loan Loss Experience**

(dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Allowance for loan losses at beginning of period	\$ 17,995	\$ 11,157	\$ 12,735	\$ 11,218
Charge offs:				
Real Estate:				
Residential	(178)	(134)	(945)	(329)
Commercial		(91)	(26)	(171)
Construction	(2,502)		(2,573)	(1)
Commercial	(36)	(69)	(98)	(87)
Consumer	(376)	(417)	(1,228)	(1,022)
Home Equity	(239)	(45)	(455)	(99)
Tax Refund Solutions	(1,335)	(6)	(9,208)	(4,246)
Total	(4,666)	(762)	(14,533)	(5,955)
Recoveries:				
Real Estate:				
Residential	32	52	139	235
Commercial	182	3	209	28
Construction				1
Commercial	12	2	17	56
Consumer	116	101	341	336
Home Equity	14	13	37	27
Tax Refund Solutions	238	160	850	953
Total	594	331	1,593	1,636
Net loan charge offs/recoveries	(4,072)	(431)	(12,940)	(4,319)
Provision for loan losses	324	1,376	14,452	5,203
Allowance for loan losses at end of period	\$ 14,247	\$ 12,102	\$ 14,247	\$ 12,102
Ratios:				
Allowance for loan losses to total loans	0.61%	0.51%	0.61%	0.51%
Allowance for loan losses to non performing loans	89	100	89	100
Annualized net loan charge offs to average loans outstanding - Total Company	0.70	0.07	0.72	0.25
Annualized net loan charge offs to average loans outstanding - Traditional Banking Segment	0.51	0.10	0.26	0.18

**Asset Quality**

The Company maintains a watch list of commercial loans and reviews those loans on a regular basis. Generally, assets are designated as watch list loans to ensure more frequent monitoring. The assets are reviewed to ensure proper earning status and management strategy. If it is determined that there is serious doubt as to performance in accordance with original terms of the contract, then the loan is placed on non accrual.

Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

Loans, including impaired loans under SFAS 114, but excluding consumer loans, are placed on non-accrual status when the loans become past due 90 days or more as to principal or interest, unless the loans are adequately secured

Table of Contents

and in the process of collection. Past due status is based on how recently payments have been received. When loans are placed on non-accrual status, all unpaid interest is reversed from interest income and accrued interest receivable. These loans remain on non-accrual status until the borrower demonstrates the ability to become and remain current or the loan or a portion of the loan is deemed uncollectible and is charged off.

Consumer loans are not placed on non-accrual status but are reviewed periodically and generally charged off when the loans reach 120 days past due or at any point the loan is deemed uncollectible. RALs traditionally undergo a review in March and July of each year and those RALs deemed uncollectible are charged off against the allowance for loan losses.

Total non performing loans to total loans increased to 0.69% at September 30, 2008, from 0.40% at December 31, 2007, as the total balance of non performing loans increased by \$6.4 million for the same period. Approximately \$4.7 million of the increase related to one land development loan in Florida. During the first nine months of 2008, the Company recorded a \$2.8 million provision for loan loss directly related to the non performing loan noted above.

The remainder of the non performing loan category remained substantially concentrated within the residential real estate and construction categories. Republic is generally well secured on these loans. As such, the Company does not anticipate a substantial increase in losses resulting from the current rise in the level of these non-performing loans at this time.

**Table 5 Non Performing Loans and Non Performing Assets**

(dollars in thousands)	September 30, 2008	December 31, 2007
Loans on non-accrual status(1)	\$ 14,763	\$ 8,303
Loans past due 90 days or more and still on accrual	1,217	1,318
Total non-performing loans	15,980	9,621
Other real estate owned	2,017	795
Total non-performing assets	\$ 17,997	\$ 10,416
Non-performing loans to total loans	0.69%	0.40%
Non-performing assets to total loans	0.78	0.43

(1) *Loans on non-accrual status include impaired loans. See Footnote 3 Loans and Allowance for Loan Losses of Item 1 Financial Statements for additional discussion regarding impaired loans.*

Republic defines impaired loans to be those commercial loans that the Company has classified as doubtful (collection of total amount due is improbable) or loss (all or a portion of the loan has been written off or a specific allowance for loss has been provided) or otherwise meet the definition of impaired. Republic's policy is to charge off all or that portion of its investment in an impaired loan upon a determination that it is probable the full amount will not be collected. Impaired loans totaled \$12.5 million at September 30, 2008 compared to \$6.4 million at December 31, 2007. The increase in impaired loans primarily related to one land development loan in Florida that was placed on non accrual during the first quarter of 2008.

**Deposits**

Total deposits declined \$168 million from December 31, 2007 to September 30, 2008 to \$1.8 billion. Interest-bearing deposits decreased \$168 million, or 10%, while non interest-bearing deposits were relatively unchanged from December 31, 2007 to September 30, 2008. The decrease in interest-bearing accounts occurred primarily in the money market and brokered deposit categories.

As previously disclosed, the Company experienced a \$48 million decline in one money market commercial relationship, as the commercial client elected to move its funds from the Bank to higher yielding investment alternatives. The client withdrew approximately \$66 million and \$9 million in deposits from the Company during the first and second quarters of 2008, respectively. During the third quarter of this year, however, the client redeposited \$27 million with the Bank at existing market terms.

Table of Contents

Brokered deposits decreased \$161 million during 2008 to \$211 million at September 30, 2008. During the fourth quarter of 2007, the Company acquired approximately \$272 million in brokered deposits to be utilized in the first quarter of 2008 to fund RALs. These deposits had a weighted average cost of 5.09% with an average maturity of 92 days. The Company also called \$56 million of brokered CDs with a weighted average interest rate of 5.40% during the first quarter of 2008. The Company replaced these brokered deposits as they matured during the first quarter of 2008 with FHLB advances.

In addition to the brokered deposits obtained during the fourth quarter of 2007, the Company also obtained \$200 million in brokered deposits during January of 2008 to fund the RAL program. These brokered deposits had a three month maturity and a weighted average rate of 4.95%. The Company replaced these brokered deposits with advances from the FHLB.

During the second quarter of 2008, the Company entered into a relationship with a large broker to obtain brokered money market deposits indexed to the three month LIBOR plus 0.25%. Due to contractual obligations that the broker has with its money market clients, this rate increased to only 3.20% at the end of the third quarter despite the fact that LIBOR increased to over 4%. At this time, management does not believe that in the near-term the rate paid on these deposits will increase from 3.20% due to the broker's contractual obligations with its clients and the market anomaly between the Fed Funds target rate and LIBOR. As of September 30, 2008, Republic had approximately \$98 million in balances from the broker with an original maximum amount of funds obtainable from the broker under its contract of \$100 million. Subsequent to the end of the quarter, both parties agreed to raise the maximum amount of funds that Republic can receive under its contract with the broker to \$200 million. Management is currently uncertain if and when the maximum may be reached due to the uncertainty in the financial markets.

**Securities Sold Under Agreements to Repurchase and Other Short-term Borrowings**

Securities sold under agreements to repurchase and other short-term borrowings declined \$76 million during 2008. The majority of the repurchase accounts are large treasury management transaction relationships with normal recurring large fluctuations in account balances. All of these accounts require security collateral on behalf of Republic. The substantial majority of these accounts are indexed to immediately repricing indices such as the Federal Funds target rate. Based on the transactional nature of the Company's treasury management accounts, repurchase agreement balances are subject to large fluctuations on a daily basis.

**Federal Home Loan Bank Advances**

FHLB advances increased \$99 million to \$577 million at September 30, 2008. The increase primarily occurred as the Company replaced maturing brokered deposits with FHLB advances.

Approximately \$150 million of the FHLB advances at September 30, 2008 and December 31, 2007 were putable advances with original fixed rate periods ranging from one to five years and original maturities ranging from three to ten years. To moderate the continued contraction on its margin, during March of 2007 the Company refinanced \$100 million in overnight borrowings from the FHLB with an approximate cost of 5.25% into a 10-year fixed rate advance with a 3-year put option at an average cost of 4.39%. At the end of the three year period, the FHLB has the right to require the Company to pay off the advances with no penalty. The weighted average coupon on all of the Company's putable advances at September 30, 2008 was 4.51%. Based on market conditions at this time, the Company does not believe that any of its putable advances are likely to be put back to the Company in the short-term by the FHLB.

### **Liquidity**

The Company's first quarter 2008 RAL program required significantly more liquidity than in prior tax seasons. In addition to the new business gained through the Jackson Hewitt relationship, the Company also experienced significant growth through its independent tax-preparer customer base. The Company utilized a securitization structure once again in 2008 to fund a significant portion of the RAL portfolio. Brokered deposits were utilized to fund all RALs not funded through the securitization structure in 2008. In March of 2008, the Company replaced approximately \$328 million of matured brokered CDs with FHLB advances.

The Company is significantly leveraged with a loan to deposit ratio of 129% at September 30, 2008 and 122% at December 31, 2007. Traditionally, the Company has utilized secured and unsecured borrowing lines to supplement

Table of Contents

its funding requirements. At September 30, 2008 and December 31, 2007, Republic had available collateral to borrow an additional \$375 million and \$545 million, respectively from the FHLB. In addition to its borrowing line with the FHLB, Republic also had unsecured lines of credit totaling \$207 million available through various other financial institutions as of September 30, 2008. If the Company were to lose a significant funding source, such as a few major depositors, or if any of its lines of credit were canceled, or if the Company cannot obtain brokered deposits, the Company would be forced to offer above market deposit interest rates to meet its funding and liquidity needs.

Republic maintains sufficient liquidity to fund routine loan demand and routine deposit withdrawal activity. Liquidity is managed by maintaining sufficient liquid assets in the form of investment securities. Funding and cash flows can also be realized by the sale of securities available for sale, principal paydowns on loans and MBSs and proceeds realized from loans held for sale. The Company's liquidity is impacted by its ability to sell certain securities, which is limited due to the level of securities that are needed to secure public deposits, securities sold under agreements to repurchase and for other purposes, as required by law. At September 30, 2008 and December 31, 2007, these securities had a fair market value of \$425 million and \$520 million, respectively. Republic's banking centers and its website, [www.republicbank.com](http://www.republicbank.com), provide access to retail deposit markets. These retail deposit products, if offered at attractive rates, have historically been a source of additional funding when needed.

At September 30, 2008, the Company had approximately \$273 million in Premier First money market accounts, which is the Bank's primary deposit product offering for medium to large business customers. These accounts do not require collateral, therefore, cash from these accounts can generally be utilized to fund the loan portfolio. The 25 largest Premier first relationships represent approximately \$135 million of the total balance. If any of these balances are moved from the Bank, the Company would likely utilize overnight borrowings in the short-term to replace the balances. One relationship elected to move \$26 million in balances away from the Company during 2008, as more favorable investment alternatives became available to the client. On a longer-term basis, the Company would likely utilize brokered deposits to replace withdrawn balances. Based on past experience utilizing brokered deposits, the Company believes it can quickly obtain brokered deposits if needed. The overall cost of gathering brokered deposits, however, could be substantially higher than the traditional retail bank deposits they replace, potentially decreasing the Company's earnings.

The Company's liquidity risk increases significantly during the first quarter of each year due to the RAL program. The Company has committed to its electronic filer and tax-preparer base that it will make RALs available to their customers under the terms of its contracts with them. This requires the Company to estimate liquidity, or funding needs for the RAL program well in advance of the tax season. If management materially overestimates the need for funding during the tax season, a significant expense could be incurred without an offsetting revenue stream. If management materially underestimates its funding needs during the tax season, the Company could experience a significant shortfall of capital needed to fund RALs and could potentially be required to stop or reduce its RAL originations.

At the time of this filing, the Company has not finalized its funding strategy for the upcoming first quarter 2009 tax season. At this time, management believes it will be able to obtain all of the funding it needs for the upcoming tax season. Similar to the first quarter of 2008, management is considering funding options, which include a combination of brokered deposits and a securitization structure. In addition, the Company is also in discussion with two large national banks for a significant on-balance sheet line of credit facility secured by RALs. Because of the significant lack of liquidity currently in the credit markets, the Company may not be able to obtain its necessary funding from a securitization structure or from the line of credit facilities with terms acceptable to the Company. If the Company cannot obtain its necessary funding from the securitization structure and/or the line of credit facilities, the Company will rely on other sources of funding such as brokered deposits and other lines of credit and may need to draw on holding company lines of credit to provide additional capital to the Bank. Regardless of the final decision related to the securitization and the on-balance sheet line of credit facilities, the Company will likely begin to increase its brokered deposit balances significantly during the fourth quarter of 2008 in anticipation of the upcoming funding needs for the tax season. *See Part II Item 1A Risk Factors for additional discussion regarding TRS and the securitization*



Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

The Parent Company's principal source of funds for dividend payments are dividends received from RB&T. Federal and state regulations limit the amount of dividends that may be paid to the Parent Company by the Bank without prior approval of the respective banking regulators. Under these regulations, the amount of dividends that may be paid in any

Table of Contents

calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years. At September 30, 2008, RB&T could, without prior approval, declare dividends of approximately \$63 million. The Company does not plan to pay dividends from its Florida subsidiary, Republic Bank, in the foreseeable future.

**Capital**

Total stockholders' equity increased from \$249 million at December 31, 2007 to \$277 million at September 30, 2008. The increase in stockholders' equity was primarily attributable to net income earned during 2008 reduced by cash dividends declared.

See Part II, Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds* for additional detail regarding stock repurchases and buy back programs.

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

Banking regulators have categorized the Bank as well-capitalized. To be categorized as well-capitalized, the Bank must maintain minimum Total Risk Based, Tier I Capital and Tier I Leverage ratios. Regulatory agencies measure capital adequacy within a framework that makes capital requirements, in part, dependent on the individual risk profiles of financial institutions. Republic continues to exceed the regulatory requirements for Total Risk Based Capital, Tier I Capital and Tier I Leverage. Republic and the Bank intend to maintain a capital position that meets or exceeds the well-capitalized requirements as defined by the Federal Reserve and FDIC. Republic's average capital to average assets ratio was 8.39% at September 30, 2008 compared to 7.86% at December 31, 2007. Formal measurements of the capital ratios for Republic and the Bank are performed by the Company at each quarter end.

In 2004, the Company executed an intragroup trust preferred transaction, with the purpose of providing RB&T access to additional capital markets, if needed, in the future. On a consolidated basis, this transaction has had no impact on the capital levels and ratios of the Company. The subordinated debentures held by RB&T, as a result of this transaction, however, are treated as Tier 2 Capital based on requirements administered by the Bank's federal banking agency. If RB&T's Tier I capital ratios should not meet the minimum requirement to be well-capitalized, the Company could immediately modify the transaction in order to maintain its well-capitalized status.

In 2005, Republic Bancorp Capital Trust ( RBCT ), an unconsolidated trust subsidiary of Republic Bancorp, Inc., was formed and issued \$40 million in Trust Preferred Securities ( TPS ). The TPS pay a fixed interest rate for ten years and adjust with LIBOR thereafter. The TPS mature on September 30, 2035 and are redeemable at the Company's option after ten years. The subordinated debentures are treated as Tier I Capital for regulatory purposes. The sole asset of RBCT represents the proceeds of the offering loaned to Republic Bancorp, Inc. in exchange for subordinated debentures which have terms that are similar to the TPS. The subordinated debentures and the related interest expense, which are

## Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

payable quarterly at the annual rate of 6.015%, are included in the consolidated financial statements. The proceeds obtained from the TPS offering have been and will continue to be utilized to fund loan growth, support an existing stock repurchase program and for other general business purposes including stock repurchases and the acquisition of GulfStream Community Bank in October of 2006.

The following table sets forth the Company's risk based capital amounts and ratios as of September 30, 2008 and December 31, 2007:

Table of Contents**Table 6 Capital Ratios**

(dollars in thousands)	As of September 30, 2008		As of December 31, 2007	
	Amount	Ratio	Amount	Ratio
<b>Total Risk Based Capital (to Risk Weighted Assets)</b>				
Republic Bancorp, Inc.	\$ 319,664	16.11%	\$ 290,155	13.90%
Republic Bank & Trust Co.	302,165	15.66	272,747	13.41
Republic Bank	12,791	24.48	13,296	23.70
<b>Tier I Capital (to Risk Weighted Assets)</b>				
Republic Bancorp, Inc.	\$ 305,417	15.39%	\$ 277,420	13.29%
Republic Bank & Trust Co.	265,069	13.74	237,018	11.66
Republic Bank	12,190	23.33	12,840	22.89
<b>Tier I Leverage Capital (to Average Assets)</b>				
Republic Bancorp, Inc.	\$ 305,417	10.18%	\$ 277,420	8.75%
Republic Bank & Trust Co.	265,069	9.02	237,018	7.66
Republic Bank	12,190	16.10	12,840	16.59

**Asset/Liability Management and Market Risk**

Asset/liability management control is designed to ensure safety and soundness, maintain liquidity and regulatory capital standards and achieve acceptable net interest income. Interest rate risk is the exposure to adverse changes in net interest income as a result of market fluctuations in interest rates. The Company, on an ongoing basis, monitors interest rate and liquidity risk in order to implement appropriate funding and balance sheet strategies. The Company considers interest rate risk to be Republic's most significant market risk.

The interest sensitivity profile of Republic at any point in time will be affected by a number of factors. These factors include the mix of interest sensitive assets and liabilities, as well as their relative pricing schedules. It is also influenced by market interest rates, deposit growth, loan growth and other factors.

Republic utilized an earnings simulation model to analyze net interest income sensitivity. Potential changes in market interest rates and their subsequent effects on net interest income are evaluated with the model. The model projects the effect of instantaneous movements in interest rates of both 100 and 200 basis point increments equally across all points on the yield curve. These projections are computed based on various assumptions, which are used to determine the 100 and 200 basis point increments, as well as the base case (which is a twelve month projected amount) scenario. Assumptions based on growth expectations and on the historical behavior of Republic's deposit and loan rates and their related balances in relation to changes in interest rates are also incorporated into the model. These assumptions are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model's simulated results due to timing, magnitude and frequency of interest rate changes, as well as changes in market conditions and the application and timing of various management strategies. Additionally, actual results could differ materially from the model if interest rates do not move equally across all points on the yield curve. As with the Company's previous simulation models, the September 30, 2008 simulation analysis continues to indicate that an increase in interest rates would generally have a negative effect on net interest income and a decrease in interest rates would generally have a positive impact on net interest income. As the Company has continued to implement strategies to mitigate the negative impact of rising interest rates, these strategies have lessened the positive impact from

declining interest rates and also reduced the Company's forecasted base case net interest income in the event of no interest rate changes.

Table of Contents

**Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

Information required by this item is included under Part I, Item 2., *Management's Discussion and Analysis of Financial Condition and Results of Operation* and Item 1A. *Risk Factors*.

**Item 4. Controls and Procedures.**

As of the end of the period covered by this report, an evaluation was carried out by Republic Bancorp, Inc.'s management, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that these disclosure controls and procedures were effective as of the end of the period covered by this report. In addition, no change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during the fiscal quarter covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings.**

In the ordinary course of operations, Republic and the Bank are defendants in various legal proceedings. In the opinion of management, there is no proceeding pending or, to the knowledge of management, threatened litigation in which an adverse decision could result in a material adverse change in the business or consolidated financial position of Republic or the Bank.

**Item 1A. Risk Factors.**

**FACTORS THAT MAY AFFECT FUTURE RESULTS**

There are factors, many beyond our control, which may significantly change the results or expectations of the Company. Some of these factors are described below in the sections titled *Company Factors* and *Industry Factors*, however, many are described in the other sections of this document and the Company's Form 10-K for the year ending December 31, 2007.

**Company Factors**

*The Company's accounting policies and estimates are critical components of the Company's presentation of its financial statements. Management must exercise judgment in selecting and adopting various accounting policies and in applying estimates. Actual outcomes may be materially different than amounts previously estimated. Management has identified six accounting policies as being critical to the presentation of the Company's financial statements. These policies are described in the Company's first quarter 2008 Form 10-Q under Part 1 Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations under the section titled Critical Accounting Policies and Estimates and relate to the following:*

- Allowance for loan losses
- Mortgage servicing rights
- Refund Anticipation Loan ( RAL ) securitization and valuation of residual
- Income tax accounting
- Goodwill and other intangible assets
- Impairment of investment securities

*The Company's lines of business and products not typically associated with traditional banking expose the Company's earnings to additional risks and uncertainties. In addition to traditional banking and mortgage banking products, the Company provides RALs and Overdraft Honor deposit accounts. The following details specific risk factors related to these lines of business:*

Table of Contents

- *RALs represent a significant business risk, and if the Company terminated the business it would materially impact the earnings of the Company.* Tax Refund Solutions ( TRS ) offers bank products to facilitate the payment of tax refunds for customers that electronically file their tax returns. The Company is one of only a few financial institutions in the U.S. that provides this service to taxpayers. Under this program, the taxpayer may receive a RAL, or an Electronic Refund Check or Electronic Refund Deposit ( ERC/ERD ). In return, the Company charges a fee for the service.

During the first nine months of 2008, net income from the Company's TRS business segment accounted for approximately 49% of the Company's total net income. Various governmental and consumer groups have, from time to time, questioned the fairness of the RAL program and have accused this industry of charging excessive/usurious rates of interest, via the fee, and engaging in predatory lending practices. Consumer groups have also claimed that customers are not adequately advised that a RAL is a loan product and that alternative, less expensive means of obtaining tax refund proceeds may be available. Actions of these groups and others could result in regulatory, governmental or legislative action or material litigation against the Company. Exiting this line of business, either voluntarily or involuntarily, would significantly reduce the Company's earnings.

*For additional discussion regarding TRS and the securitization, see the sections titled Footnote 9 Segment Information and Footnote 10 Securitization of Part 1 Item 1 Financial Statements, as well as Results of Operations in Part 1 Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations.*

- *The TRS business segment represents a significant operational risk, and if the Company were unable to properly service the anticipated growth in the business it could materially impact the earnings of the Company.* As previously disclosed, during the first quarter of 2008, the Company substantially grew its business over prior year due to several new relationships and increased volume from existing relationships. The primary reason for this increase was the announced exiting of this business line by a large competitor of Republic.

Continued growth in this business segment requires continued increases in technology and employees to service the new business. In order to process the new business, the Company must implement and test new systems, as well as train new employees. Significant operational problems could cause the Company to incur higher than normal credit losses. Significant operational problems could also cause a material portion of the Company's tax-preparer base to switch to a competitor bank to process their bank product transactions, significantly reducing the Company's projected revenue without a corresponding decrease in expenses.

*For additional discussion regarding TRS and the securitization, see the sections titled Footnote 9 Segment Information and Footnote 10 Securitization of Part 1 Item 1 Financial Statements, as well as Results of Operations in Part 1 Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations.*

- *RALs represent a significant compliance and regulatory risk, and if the Company fails to comply with all statutory and regulatory requirements it could have a material negative impact on the Company's earnings.* Federal and state laws and regulations govern numerous matters relating to the offering of RALs. Failure to comply with



*disclosure requirements such as Regulation B, Fair Lending and Regulation Z, Truth in Lending, or with laws relating to the permissibility of interest rates and fees charged could have a material negative impact on the Company's earnings.*

*For additional discussion regarding TRS and the securitization, see the sections titled Footnote 9 Segment Information and Footnote 10 Securitization of Part 1 Item 1 Financial Statements, as well as Results of Operations in Part 1 Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations.*

- *RALs represent a significant liquidity, or funding, risk. Significantly overestimating or underestimating the Company's liquidity or funding needs for the upcoming tax season could have a material negative impact on the Company's overall earnings. Funding for RAL liquidity requirements may also cost more than the*

Table of Contents

*Company's current estimates and/or historical experience.* The Company's liquidity risk increases significantly during the first quarter of each year due to the RAL program. The Company has committed to its electronic filer and tax-preparer base that it will make RALs available to their customers under the terms of its contracts with them. This requires the Company to estimate liquidity, or funding, needs for the RAL program well in advance of the tax season. If management materially overestimates the need for funding during the tax season, a significant expense could be incurred without an offsetting revenue stream. If management materially underestimates its funding needs during the tax season, the Company could experience a significant shortfall of capital needed to fund RALs and could potentially be required to stop or reduce its RAL originations.

At the time of this filing, the Company has not finalized its funding strategy for the upcoming first quarter 2009 tax season. At this time, management believes it will be able to obtain all of the funding it needs for the upcoming tax season. Similar to the first quarter of 2008, management is considering funding options, which include a combination of brokered deposits and a securitization structure. In addition, the Company is also in discussion with two large national banks for a significant on-balance sheet line of credit facility secured by RALs. Because of the significant lack of liquidity currently in the credit markets, the Company may not be able to obtain its necessary funding from a securitization structure or from the line of credit facilities with terms acceptable to the Company. If the Company cannot obtain its necessary funding from the securitization structure and/or the line of credit facilities, the Company will rely on other sources of funding such as brokered deposits and other lines of credit and may need to draw on holding company lines of credit to provide additional capital to the Bank. Regardless of the final decision related to the securitization and the on-balance sheet line of credit facilities, the Company will likely begin to increase its brokered deposit balances significantly during the fourth quarter of 2008 in anticipation of the upcoming funding needs for the tax season.

*For additional discussion regarding TRS and the securitization, see the sections titled Footnote 9 Segment Information and Footnote 10 Securitization of Part 1 Item 1 Financial Statements, as well as Results of Operations in Part 1 Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations.*

- *RALs represent a significant credit risk, and if the Company is unable to collect a significant portion of its RALs it would materially impact the earnings of the Company.* There is credit risk associated with a RAL because the funds are disbursed to the customer prior to the Company receiving the customer's refund from the Internal Revenue Service ( IRS ). The Company collects substantially all of its payments related to RALs from the IRS. Losses generally occur on RALs because the Company does not receive payment from the IRS due to reasons such as taxpayer or tax-preparer fraud, taxpayer or tax-preparer tax return errors, and tax debts not disclosed to the Company, among other reasons.

Historically at TRS, credit losses related to RALs within a given calendar year have ranged from a low of 0.49% to a high of 1.70% of total RALs originated (including retained and securitized RALs). During the first nine months of 2008, the Company incurred \$16.2 million in gross losses associated with RALs both retained on balance sheet by the Company and securitized by the Company. Losses as a percent of total gross RALs originated (including retained and securitized RALs) during the first nine months of 2008 were 0.91%.

Although the Company expects losses for the upcoming first quarter 2009 tax season to track within historical levels in terms of percentage of total loans originated, management cannot guarantee any range of losses associated with the RAL business. Losses significantly above historical levels could have a material negative impact on the Company's overall earnings.

*For additional discussion regarding TRS and the securitization, see the sections titled Footnote 9 Segment Information and Footnote 10 Securitization of Part 1 Item 1 Financial Statements, as well as Results of Operations in Part 1 Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations.*

- *Republic has substantial risk in connection with the RAL securitization.* A residual represents the retained interest created in a securitization and typically represents the first loss position. Residuals are not typically

Table of Contents

rated by nationally recognized rating agencies. In a securitization transaction, the Company may recognize a gain on sale resulting from the related residual in the securitized loans when it sells the assets. The value assigned to the residual depends upon certain assumptions made regarding the future performance of the securitized loan portfolio, including the level of credit losses. If actual credit losses differ from the original assumptions, the value of the residual may decrease materially, possibly resulting in a charge against future earnings. Decreases in the value of the residual in the securitization due to higher than expected credit losses could have a material adverse effect on the Company's business, financial condition and results of operations.

*For additional discussion regarding TRS and the securitization, see the sections titled Footnote 9 Segment Information and Footnote 10 Securitization of Part 1 Item 1 Financial Statements, as well as Results of Operations in Part 1 Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations.*

- *The Company's Overdraft Honor program represents a significant business risk, and if the Company terminated the program it would materially impact the earnings of the Company. There can be no assurance that the Company's regulators, or others, will not impose additional limitations on this program or prohibit the Company from offering the program.* The Company's Overdraft Honor program permits eligible customers to overdraft their checking accounts up to a predetermined dollar amount for the Bank's customary overdraft fee(s). Generally, to be eligible for the Overdraft Honor program, customers must qualify for one of the Company's traditional checking products when the account is opened and remain in that product for 30 days; have deposits of at least \$500; and have had no overdrafts or returned deposited items. Once the eligibility requirements have been met, the client is eligible to participate in the Overdraft Honor program. If an overdraft occurs, the Company may pay the overdraft, at its discretion, up to \$500 (an account in good standing after two years is eligible for up to \$1,000). Under regulatory guidelines, customers utilizing the Overdraft Honor program may remain in overdraft status for no more than 45 days. Generally, an account that is overdrawn for 60 consecutive days is closed and the balance is charged off.

Overdraft balances from deposit accounts, including those overdraft balances resulting from the Company's Overdraft Honor program, are recorded as a component of loans on the Company's balance sheet.

The Company assesses two types of fees related to overdrawn accounts, a fixed per item fee and a fixed daily charge for being in overdraft status. The per item fee for this service is not considered an extension of credit, but rather is considered a fee for paying checks when sufficient funds are not otherwise available. As such, it is classified on the income statement in service charges on deposits as a component of non interest income along with per item fees assessed to customers not in the Overdraft Honor program. A substantial majority of the per item fees in service charges on deposits relates to customers in the Overdraft Honor program. The daily fee assessed to the client for being in overdraft status is considered a loan fee and is thus included in interest income on loans.

The Company earns a substantial majority of its fee income related to this program from the per item fee it assesses its customers for each insufficient funds check or electronic debit presented for payment. Both the per item fee and the daily fee assessed to the account resulting from its overdraft status, if computed as a percentage of the amount overdrawn, results in a high rate of interest when annualized and are thus considered excessive by some consumer groups. The total net per item fees included in service charges on deposits for the nine months ended September 30, 2008 and 2007 were \$10.3 million and \$10.1 million. The total net daily overdraft charges included in interest income for the nine months ended September 30 2008 and 2007 were \$2.0 million. Additional limitations or elimination, or adverse modifications to this program, either voluntary or involuntary, would significantly reduce Company earnings.

*The Company owns \$21 million of securities which the Company believes have an elevated level of credit risk and are extremely illiquid.* Nationally, residential real estate values declined significantly during 2007 and 2008. These declines in value, coupled with the reduced ability of certain homeowners to refinance or repay their residential real estate obligations, have led to elevated delinquencies and losses in residential real estate loans. Many of these loans have previously been securitized and sold to investors as non agency mortgage backed or other non agency mortgage-related securities. The Company currently owns five non agency mortgage backed and other non agency mortgage-related securities with a fair value of \$21.1 million at September 30, 2008. These securities are not

Table of Contents

guaranteed by government agencies. Approximately \$14.4 million of these securities are mostly backed by Alternative A first lien mortgage loans. The remaining \$6.7 million represents an asset backed security with an insurance wrap or guarantee. The average life of these securities is currently estimated to be approximately five years. Due to current market conditions, all of these assets are extremely illiquid, and as such, the Company determined that these securities are Level 3 securities in accordance with FSP No. 157-3 *Determining the Fair Value of a Financial Asset When the Market for that Asset Is Not Active*, which was issued in October 2008. Based on this determination, the Company utilized an income valuation model as of September 30, 2008, as opposed to a market valuation approach, in determining the fair value of these securities. The income valuation model (present value model) maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Management believes the income valuation model is more representative of the fair value for these securities than the market valuation technique used at prior measurement dates.

Prior to the second quarter of 2008, unrealized losses on the Company's non agency mortgage backed securities and other non agency mortgage related securities were not recognized into income because the bonds were deemed to be of sufficient credit quality (rated A+, Aa1 or higher) and the Company had the intent and ability to hold the securities until maturity. The Company evaluated the performance of the loans underlying these securities and concluded it would likely continue to receive the future expected cash flows of these securities in accordance with their original terms. As such, prior to the second quarter of 2008, the Company concluded that the fair value of all non agency mortgage backed securities and other non agency mortgage related securities would recover as the securities approached maturity.

During the second quarter of 2008, the Company recorded a non cash OTTI charge totaling \$3.4 million for two of its available for sale non agency mortgage backed and other non agency mortgage related securities. During the third quarter of 2008, the Company recorded another non cash OTTI charge totaling \$3.9 million related to another available for sale non agency mortgage backed and other non-agency mortgage related security. As of the end of the third quarter, no impairment charge had been recorded on two of the securities, which were rated AAA by S&P and had a amortized cost of \$7.5 million. *See additional discussion regarding these impairment charges under Footnote 2 Securities.*

Further deterioration in economic conditions and/or new or additional downgrades from applicable rating agencies could cause the Company to record additional impairment charges in the future.

*Mortgage banking activities are significantly impacted by changing long-term interest rates. Changes in interest rates can impact the gain on sale of loans, loan origination fees and loan servicing fees, which account for a significant portion of mortgage banking income. A decline in interest rates generally results in higher demand for mortgage products, while an increase in rates generally results in reduced demand. If demand increases, mortgage banking income will be positively impacted by more gains on sale; however, the valuation of existing mortgage servicing rights will decrease and may result in a significant impairment. Moreover, a decline in demand for mortgage banking products could also adversely impact other programs/products such as home equity lending, title insurance commissions and service charges on deposit accounts. See additional discussion about this product under the section titled: Item 2*

*Management's Discussion and Analysis of Financial Condition and Results of Operations and Footnote 9 Segment Information of Item 1 Financial Statements.*

*The Company's stock generally has a low average daily trading volume, which limits a stockholder's ability to quickly accumulate or quickly sell large numbers of shares of Republic's stock without causing wide price fluctuations. Republic's stock price can fluctuate widely in response to a variety of factors, such as actual or anticipated variations in the Company's operating results, recommendations by securities analysts, operating and stock price performance of other companies, news reports,*

results of litigation, regulatory actions or changes in government regulations, among other factors. A low average daily stock trading volume can lead to significant price swings even when a relatively small number of shares are being traded.

*The Company's insiders hold voting rights that give them significant control over matters requiring stockholder approval. The Company's Chairman, President, and Vice Chairman hold substantial amounts of the Company's Class A Common Stock and Class B Common Stock. Each share of Class A Common Stock is entitled to one vote and each share of Class B Common Stock is entitled to ten votes. This group generally votes together on matters presented to stockholders for approval. Consequently, other stockholders' ability to influence the Company's actions through their vote may be limited and the non-insider stockholders may not have sufficient voting power to approve*

Table of Contents

a change in control even if a significant premium is being offered for their shares. The Company cannot assure you that majority stockholders will vote their shares in accordance with minority stockholder interests.

**Industry Factors**

*Fluctuations in interest rates may negatively impact the Company's banking business. Republic's core source of income from operations consists of net interest income, which is equal to the difference between interest income received on interest-earning assets (typically loans and investment securities) and the interest expenses incurred in connection with interest-bearing liabilities (typically deposits and borrowing sources). These rates are highly sensitive to many factors beyond the Company's control, including general economic conditions, both domestic and foreign, and the monetary and fiscal policies of various governmental and regulatory authorities. Republic's net interest income can be affected significantly by changes in market interest rates. Changes in interest rates may reduce Republic's net interest income as the difference between interest income and interest expense declines. As a result, Republic has adopted asset and liability management policies to minimize potential adverse effects of changes in interest rates on net interest income, primarily by altering the mix and maturity of loans, investments and funding sources. However, even with these policies in place, changes in interest rates could negatively impact the Company's results of operations or financial position.*

An increase in interest rates could also have a negative impact on Republic's results of operations by reducing the ability of customers to repay their outstanding loans, which could not only result in increased loan defaults, foreclosures and charge offs, but may also likely necessitate further increases to Republic's allowance for loan losses.

*The Company is significantly impacted by the regulatory, fiscal and monetary policies of federal and state governments which could negatively impact the Company's liquidity position and earnings. These policies can materially affect the value of the Company's financial instruments and can also adversely affect the Company's customers and their ability to repay their outstanding loans. Also, failure to comply with laws, regulations or policies, or adverse examination findings, could result in significant penalties, negatively impact operations, or result in other sanctions against the Company.*

The Board of Governors of the Federal Reserve Bank (FRB) regulates the supply of money and credit in the U.S. Its policies determine, in large part, the Company's cost of funds for lending and investing and the return the Company earns on these loans and investments, all of which impact net interest margin.

The Company and the Bank are heavily regulated at both the federal and state levels. This regulatory oversight is primarily intended to protect depositors, the Deposit Insurance Fund (DIF) and the banking system as a whole, not the stockholders of the Company. Changes in policies, regulations and statutes, or the interpretation thereof, could significantly impact the product offerings of Republic causing the Company to terminate or modify its product offerings in a manner that could materially adversely affect the earnings of the Company.



## Edgar Filing: REPUBLIC BANCORP INC /KY/ - Form 10-Q

Federal and state laws and regulations govern numerous matters including changes in the ownership or control of banks and bank holding companies, maintenance of adequate capital and the financial condition of a financial institution, permissible types, amounts and terms of extensions of credit and investments, permissible non-banking activities, the level of reserves against deposits and restrictions on dividend payments. Various federal and state regulatory agencies possess cease and desist powers, and other authority to prevent or remedy unsafe or unsound practices or violations of law by banks subject to their regulations. The FRB possesses similar powers with respect to bank holding companies. These, and other restrictions, can limit in varying degrees, the manner in which Republic conducts its business.

*Republic is subject to regulatory capital adequacy guidelines, and if the Company fails to meet these guidelines the Company's financial condition may be adversely affected.* Under regulatory capital adequacy guidelines, and other regulatory requirements, Republic and the Bank must meet guidelines that include quantitative measures of assets, liabilities and certain off balance sheet items, subject to qualitative judgments by regulators regarding components, risk weightings and other factors. If Republic fails to meet these minimum capital guidelines and other regulatory requirements, Republic's financial condition will be materially and adversely affected. If Republic's fails to maintain well-capitalized status under its regulatory framework, or deemed not well-managed under regulatory exam procedures, or if it should experience certain regulatory violations, Republic's status as a Financial Holding

Table of Contents

Company and its related eligibility for a streamlined review process for acquisition proposals, and its ability to offer certain financial products could be compromised.

*The Company's financial condition and earnings could be negatively impacted to the extent the Company relies on information that is false, misleading or inaccurate.* The Company relies on the accuracy and completeness of information provided by vendors, customers and other parties. In deciding whether to extend credit, including RALs, or enter into transactions with other parties, the Company relies on information furnished by, or on behalf of, customers or entities related to those customers or other parties.

*Defaults in the repayment of loans may negatively impact the Company.* When borrowers default on obligations of one or more of their loans, it may result in lost principal and interest income and increased operating expenses, as a result of the increased allocation of management time and resources to the subsequent collection efforts. In certain situations where collection efforts are unsuccessful or acceptable work out arrangements cannot be reached or performed, the Company may have to charge off loans, either in part or in whole.

*Prepayment of loans may negatively impact Republic's business.* The Company's customers may prepay the principal amount of their outstanding loans at any time. The speeds at which such prepayments occur, as well as the size of such prepayments, are within the Company's customers' discretion. If customers prepay the principal amount of their loans, and the Company is unable to lend those funds to other customers or invest the funds at the same or higher interest rates, Republic's interest income will be reduced. A significant reduction in interest income would have a negative impact on Republic's results of operations and financial condition.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

Details of Republic's Class A Common Stock purchases during the third quarter of 2008 are included in the following table:

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares that May Yet Be Purchased Under the Plan or Programs</b>
July 1 - July 31	5,792	\$ 27.28		
August 1 - August 31	810	32.61		
September 1 - September 30				
<b>Total</b>	<b>6,602*</b>	<b>\$ 28.30</b>		<b>89,053</b>

\* - Represents shares received by the Company in connection with stock option exercises.

During the first nine months of 2008, the Company repurchased 14,000 shares and there were 92,428 shares exchanged for stock option exercises. During the second quarter of 2007, the Company's Board of Directors amended its existing share repurchase program by approving the repurchase of an additional 300,000 shares from time to time, as market conditions are deemed favorable to the Company. The repurchase program will remain effective until the total number of shares authorized is repurchased or until Republic's Board of Directors terminates the program. As of September 30, 2008, the Company had 89,053 shares which could be repurchased under the current share repurchase programs.

During the first nine months of 2008, there were approximately 22,000 shares of Class A Common Stock issued upon conversion of shares of Class B Common Stock by stockholders of Republic in accordance with the share-for-share conversion provision option of the Class B Common Stock. The exemption from registration of the newly issued Class A Common Stock relied upon was Section (3)(a)(9) of the Securities Act of 1933.

There were no equity securities of the registrant sold without registration during the quarter covered by this report.

Table of Contents

**Item 6. Exhibits.**

(a) Exhibits

The following exhibits are filed or furnished as a part of this report:

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
31.1	Certification of Principal Executive Officer pursuant to the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to the Sarbanes-Oxley Act of 2002.
10.1	Appointment of Ted M. Parker as CEO Acquisitions and Corporate Strategy (Incorporated by reference to Form 8-K filed August 22, 2008 (commission File Number: 0-24649
32*	Certification of Principal Executive Officer and Principal Financial Officer, pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

---

\* - *This certification shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.*

Table of Contents

**SIGNATURES**

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

**REPUBLIC BANCORP, INC.**  
(Registrant)

**Principal Executive Officer:**

October 28, 2008

By: Steven E. Trager  
President and Chief Executive Officer

**Principal Financial Officer:**

October 28, 2008

By: Kevin Sipes  
Executive Vice President, Chief Financial  
Officer and Chief Accounting Officer