

SOUTH STATE Corp
Form 10-Q
August 03, 2018
Table of Contents

G3

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 001-12669

SOUTH STATE CORPORATION

(Exact name of registrant as specified in its charter)

South Carolina 57-0799315
(State or other jurisdiction of incorporation) (IRS Employer Identification No.)

520 Gervais Street
Columbia, South Carolina 29201
(Address of principal executive offices) (Zip Code)

(800) 277-2175

(Registrant's telephone number, including area code)

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

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

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

Large Accelerated Filer Accelerated Filer
Non-Accelerated Filer Smaller Reporting Company

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Emerging Growth Company

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

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

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

Class	Outstanding as of July 31, 2018
Common Stock, \$2.50 par value	36,830,002

Table of Contents

South State Corporation and Subsidiary

June 30 2018 Form 10-Q

INDEX

	Page
<u>PART I — FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets at June 30, 2018, December 31, 2017 and June 30, 2017</u>	3
<u>Condensed Consolidated Statements of Income for the Three and Six Months Ended June 30, 2018 and 2017</u>	4
<u>Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2018 and 2017</u>	5
<u>Condensed Consolidated Statements of Changes in Shareholders' Equity for the Six Months Ended June 30, 2018 and 2017</u>	6
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2018 and 2017</u>	7
<u>Notes to Condensed Consolidated Financial Statements</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	57
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	84
<u>Item 4. Controls and Procedures</u>	84
<u>PART II — OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	85
<u>Item 1A. Risk Factors</u>	85
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	85
<u>Item 3. Defaults Upon Senior Securities</u>	85
<u>Item 4. Mine Safety Disclosures</u>	86

<u>Item 5.</u> <u>Other Information</u>	86
<u>Item 6.</u> <u>Exhibits</u>	86

Table of Contents

PART I — FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

South State Corporation and Subsidiary

Condensed Consolidated Balance Sheets

(Dollars in thousands, except par value)

	June 30, 2018 (Unaudited)	December 31, 2017	June 30, 2017 (Unaudited)
ASSETS			
Cash and cash equivalents:			
Cash and due from banks	\$ 250,106	\$ 255,775	\$ 225,259
Interest-bearing deposits with banks	73,013	117,635	185,472
Federal funds sold and securities purchased under agreements to resell	73,730	4,217	21,159
Total cash and cash equivalents	396,849	377,627	431,890
Investment securities:			
Securities held to maturity (fair value of \$503, \$2,556 and \$4,248, respectively)	499	2,529	4,166
Securities available for sale, at fair value	1,577,999	1,648,193	1,340,427
Other investments	19,229	23,047	14,301
Total investment securities	1,597,727	1,673,769	1,358,894
Loans held for sale	36,968	70,890	65,995
Loans:			
Acquired credit impaired, net of allowance for loan losses	551,979	618,803	602,481
Acquired non-credit impaired	3,076,424	3,507,907	1,585,981
Non-acquired	7,197,539	6,492,155	5,992,393
Less allowance for non-acquired loan losses	(47,874)	(43,448)	(40,149)
Loans, net	10,778,068	10,575,417	8,140,706
Other real estate owned	17,222	11,203	14,430
Premises and equipment, net	245,288	255,565	201,539
Bank owned life insurance	227,588	225,132	150,476
Deferred tax assets	48,853	45,902	39,921
Mortgage servicing rights	35,107	31,119	29,930
Core deposit and other intangibles	69,975	73,789	52,966
Goodwill	1,002,722	999,586	595,817
Other assets	110,121	126,590	71,877
Total assets	\$ 14,566,488	\$ 14,466,589	\$ 11,154,441
LIABILITIES AND SHAREHOLDERS' EQUITY			
Deposits:			

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Noninterest-bearing	\$ 3,152,828	\$ 3,047,432	\$ 2,635,147
Interest-bearing	8,485,461	8,485,334	6,396,507
Total deposits	11,638,289	11,532,766	9,031,654
Federal funds purchased and securities sold under agreements to repurchase	331,969	286,857	334,018
Other borrowings	115,754	216,385	98,147
Other liabilities	132,109	121,661	85,137
Total liabilities	12,218,121	12,157,669	9,548,956
Shareholders' equity:			
Common stock - \$2.50 par value; authorized 80,000,000; 80,000,000 and 40,000,000 shares, respectively; 36,825,556; 36,759,656 and 29,259,264 shares issued and outstanding, respectively	92,064	91,899	73,148
Surplus	1,811,446	1,807,601	1,134,328
Retained earnings	480,928	419,847	401,706
Accumulated other comprehensive loss	(36,071)	(10,427)	(3,697)
Total shareholders' equity	2,348,367	2,308,920	1,605,485
Total liabilities and shareholders' equity	\$ 14,566,488	\$ 14,466,589	\$ 11,154,441

The Accompanying Notes are an Integral Part of the Financial Statements.

Table of Contents

South State Corporation and Subsidiary

Condensed Consolidated Statements of Income (unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30,	2017	June 30,	2017
	2018		2018	
Interest income:				
Loans, including fees	\$ 129,852	\$ 93,600	\$ 256,893	\$ 185,352
Investment securities:				
Taxable	9,048	7,020	17,836	14,251
Tax-exempt	1,614	1,397	3,173	2,827
Federal funds sold and securities purchased under agreements to resell	1,218	762	1,878	1,335
Total interest income	141,732	102,779	279,780	203,765
Interest expense:				
Deposits	10,009	2,661	16,922	5,158
Federal funds purchased and securities sold under agreements to repurchase	642	240	1,096	480
Other borrowings	1,519	847	3,227	1,734
Total interest expense	12,170	3,748	21,245	7,372
Net interest income	129,562	99,031	258,535	196,393
Provision for loan losses	4,478	2,313	6,932	6,020
Net interest income after provision for loan losses	125,084	96,718	251,603	190,373
Noninterest income:				
Fees on deposit accounts	22,612	19,897	45,155	39,398
Mortgage banking income	3,317	5,195	8,265	10,764
Trust and investment services income	7,567	6,452	15,081	12,393
Securities gains (losses), net	(641)	110	(641)	110
Recoveries on acquired loans	2,167	2,171	5,142	3,703
Other	2,503	1,491	5,078	3,165
Total noninterest income	37,525	35,316	78,080	69,533
Noninterest expense:				
Salaries and employee benefits	55,026	47,580	117,491	96,466
Net occupancy expense	7,815	6,048	15,981	12,436
Information services expense	8,903	6,413	18,641	12,773
Furniture and equipment expense	4,519	3,877	9,145	7,671
OREO expense and loan related	1,037	1,753	2,698	3,895
Bankcard expense	311	628	1,002	1,180
Amortization of intangibles	3,722	2,495	7,135	5,002
Supplies, printing and postage expense	1,406	1,570	2,798	3,224
Professional fees	1,898	1,599	3,597	3,372
FDIC assessment and other regulatory charges	3,277	989	4,540	2,111
Advertising and marketing	1,163	989	1,899	1,548

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Merger and branch consolidation related expense	14,096	4,307	25,392	25,331
Other	7,333	6,033	13,650	11,777
Total noninterest expense	110,506	84,281	223,969	186,786
Earnings:				
Income before provision for income taxes	52,103	47,753	105,714	73,120
Provision for income taxes	11,644	15,930	22,929	23,033
Net income	\$ 40,459	\$ 31,823	\$ 82,785	\$ 50,087
Earnings per common share:				
Basic	\$ 1.10	\$ 1.09	\$ 2.25	\$ 1.73
Diluted	\$ 1.09	\$ 1.08	\$ 2.24	\$ 1.71
Dividends per common share	\$ 0.34	\$ 0.33	\$ 0.67	\$ 0.66
Weighted average common shares outstanding:				
Basic	36,677	29,095	36,657	28,985
Diluted	36,929	29,365	36,910	29,252

The Accompanying Notes are an Integral Part of the Financial Statements.

Table of Contents

South State Corporation and Subsidiary

Condensed Consolidated Statements of Comprehensive Income (unaudited)

(Dollars in thousands)

	Three Months Ended		Six Months Ended	
	June 30,	2017	June 30,	2017
	2018		2018	
Net income	\$ 40,459	\$ 31,823	\$ 82,785	\$ 50,087
Other comprehensive income:				
Unrealized gains (losses) on securities:				
Unrealized holding gains (losses) arising during period	(8,216)	1,803	(30,298)	6,920
Tax effect	1,807	(688)	6,697	(2,638)
Reclassification adjustment for (gains) losses included in net income	641	(110)	641	(110)
Tax effect	(141)	43	(141)	42
Net of tax amount	(5,909)	1,048	(23,101)	4,214
Unrealized gains (losses) on derivative financial instruments qualifying as cash flow hedges:				
Unrealized holding gains (losses) arising during period	8	18	44	(60)
Tax effect	(2)	(7)	(10)	23
Reclassification adjustment for losses included in interest expense	39	19	87	168
Tax effect	(8)	(7)	(19)	(64)
Net of tax amount	37	23	102	67
Change in pension plan obligation:				
Reclassification adjustment for changes included in net income	194	187	387	376
Tax effect	(43)	(71)	(85)	(143)
Net of tax amount	151	116	302	233
Other comprehensive gain (loss), net of tax	(5,721)	1,187	(22,697)	4,514
Comprehensive income	\$ 34,738	\$ 33,010	\$ 60,088	\$ 54,601

The Accompanying Notes are an Integral Part of the Financial Statements.

Table of Contents

South State Corporation and Subsidiary

Condensed Consolidated Statements of Changes in Shareholders' Equity (unaudited)

Six months ended June 30, 2018 and 2017

(Dollars in thousands, except for share data)

	Common Stock Shares	Common Stock Amount	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2016	24,230,392	\$ 60,576	\$ 711,307	\$ 370,916	\$ (8,211)	\$ 1,134,588
Comprehensive income	—	—	—	50,087	4,514	54,601
Cash dividends declared on common stock at \$0.66 per share	—	—	—	(19,297)	—	(19,297)
Common stock issued for Southeastern Bank Financial Corp. acquisition	4,978,338	12,446	422,163	—	—	434,609
Employee stock purchases	3,226	8	259	—	—	267
Stock options exercised	33,896	84	1,050	—	—	1,134
Restricted stock awards	15,851	39	(39)	—	—	—
Stock issued pursuant to restricted stock units	37,802	95	(95)	—	—	—
Common stock repurchased	(40,241)	(100)	(3,505)	—	—	(3,605)
Share-based compensation expense	—	—	3,188	—	—	3,188

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Balance, June 30, 2017	29,259,264	\$ 73,148	\$ 1,134,328	\$ 401,706	\$ (3,697)	\$ 1,605,485
Balance, December 31, 2017	36,759,656	\$ 91,899	\$ 1,807,601	\$ 419,847	\$ (10,427)	\$ 2,308,920
Comprehensive income	—	—	—	82,785	(22,697)	60,088
Cash dividends declared on common stock at \$0.67 per share	—	—	—	(24,651)	—	(24,651)
AOCI reclassification to retained earnings from adoption of ASU 2018-02	—	—	—	2,947	(2,947)	—
Employee stock purchases	4,338	11	341	—	—	352
Stock options exercised	33,424	83	948	—	—	1,031
Restricted stock awards	7,836	20	(20)	—	—	—
Common stock repurchased	(19,239)	(48)	(1,678)	—	—	(1,726)
Stock issued pursuant to restricted stock units	39,541	99	(99)	—	—	—
Share-based compensation expense	—	—	4,353	—	—	4,353
Balance, June 30, 2018	36,825,556	\$ 92,064	\$ 1,811,446	\$ 480,928	\$ (36,071)	\$ 2,348,367

The Accompanying Notes are an Integral Part of the Financial Statements.

Table of Contents

South State Corporation and Subsidiary

Condensed Consolidated Statements of Cash Flows (unaudited)

(Dollars in thousands)

	Six Months Ended	
	June 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$ 82,785	\$ 50,087
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,025	14,064
Provision for loan losses	6,932	6,020
Deferred income taxes	5,517	4,040
(Gain) loss on sale of securities, net	641	(110)
Share-based compensation expense	4,353	3,188
Accretion of discount related to performing acquired loans	(17,251)	(7,543)
(Gain) loss on disposal of premises and equipment	1,266	(15)
Gain on sale of OREO	(204)	(188)
Net amortization of premiums on investment securities	3,843	3,338
OREO write downs	932	1,729
Fair value adjustment for loans held for sale	(208)	1,332
Originations and purchases of loans held for sale	(324,803)	(367,673)
Proceeds from sales of loans	358,929	364,570
Net change in:		
Accrued interest receivable	(1,023)	558
Prepaid assets	(52)	387
Miscellaneous other assets	8,819	(914)
Accrued interest payable	1,093	(469)
Accrued income taxes	6,404	5,798
Miscellaneous other liabilities	4,188	(3,004)
Net cash provided by operating activities	160,186	75,195
Cash flows from investing activities:		
Proceeds from sales of investment securities available for sale	51,822	215,987
Proceeds from maturities and calls of investment securities held to maturity	2,030	1,930
Proceeds from maturities and calls of investment securities available for sale	114,825	131,250
Proceeds from sales of other investment securities	13,175	2,807
Purchases of investment securities available for sale	(130,378)	(101,925)
Purchases of other investment securities	(9,356)	(303)
Net increase in loans	(207,909)	(449,052)
Net cash received from acquisitions	—	71,607
Recoveries of loans previously charged off	2,104	1,340
Purchases of premises and equipment	(7,268)	(6,095)
Proceeds from sale of OREO	3,722	7,677
Proceeds from sale of premises and equipment	18	15

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Net cash used in investing activities	(167,215)	(124,762)
Cash flows from financing activities:		
Net increase in deposits	106,135	176,311
Net increase in federal funds purchased and securities sold under agreements to repurchase and other short-term borrowings	45,112	19,231
Proceeds from FHLB advances	260,001	—
Repayment of other borrowings	(360,003)	(67,032)
Common stock issuance	352	267
Common stock repurchase	(1,726)	(3,605)
Dividends paid on common stock	(24,651)	(19,297)
Stock options exercised	1,031	1,134
Net cash provided by financing activities	26,251	107,009
Net increase in cash and cash equivalents	19,222	57,442
Cash and cash equivalents at beginning of period	377,627	374,448
Cash and cash equivalents at end of period	\$ 396,849	\$ 431,890
Supplemental Disclosures:		
Cash Flow Information:		
Cash paid for:		
Interest	\$ 20,152	\$ 7,841
Income taxes	\$ 11,796	\$ 11,850
Schedule of Noncash Investing Transactions:		
Acquisitions:		
Fair value of tangible assets acquired	\$ (7,068)	\$ 1,816,592
Other intangible assets acquired	3,321	18,120
Liabilities assumed	(612)	1,656,967
Net identifiable assets acquired over liabilities assumed	(3,135)	177,745
Common stock issued in acquisition	—	434,625
Real estate acquired in full or in partial settlement of loans	\$ 10,259	\$ 4,947

The Accompanying Notes are an Integral Part of the Financial Statements.

Table of Contents

South State Corporation and Subsidiary

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 — Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain prior period information has been reclassified to conform to the current period presentation, and these reclassifications had no impact on net income or equity as previously reported. Operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

The condensed consolidated balance sheet at December 31, 2017 has been derived from the audited financial statements at that date but does not include all of the information and disclosures required by GAAP for complete financial statements.

Note 2 — Summary of Significant Accounting Policies

The information contained in the consolidated financial statements and accompanying notes included in South State Corporation’s (“SSB’s”) Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the Securities and Exchange Commission (the “SEC”) on February 23, 2018, should be referenced when reading these unaudited condensed consolidated financial statements. Unless otherwise mentioned or unless the context requires otherwise, references herein to “South State,” the “Company” “we,” “us,” “our” or similar references mean South State Corporation and its consolidated subsidiary. References to the “Bank” means South State Corporation’s wholly owned subsidiary, South State Bank, a South Carolina banking corporation.

Revenue from Contracts with Customers (Topic 606) and Method of Adoption

On January 1, 2018, we adopted the requirements of Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers (“ASU Topic 606”). The majority of our revenue is derived primarily from interest income from receivables (loans) and securities. Other revenues are derived from fees received in connection with deposit accounts, mortgage banking activities including gains from the sale of loans and loan origination fees, and trust and investment advisory services. The core principle of the new standard is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The Company adopted ASU Topic 606 using the retrospective transition approach which requires restatement of prior periods. We selected this method even though there were no material changes in the timing of revenue recognition due to the fact that ASU Topic 606 requires us to report network costs associated with debit card and ATM transactions netted against the related fees from such transactions. Previously, such network costs were reported as a component of other noninterest expense. We did restate prior periods for this reclassification. For the three and six months ended June 30, 2018, gross interchange and debit card transaction fees totaled \$11.1 million and \$21.7 million, respectively while related network costs totaled \$3.0 million and \$6.0 million, respectively. On a net basis we reported \$8.1 million and \$15.7 million, respectively, as interchange and debit card transactions fees in the accompanying Consolidated Statements of Income as noninterest income for the three and six months ended June 30, 2018. We also made this reclassification for the comparable periods in 2017. For the three and six months ended June 30, 2017, gross interchange and debit card transaction fees totaled \$9.0 million and \$17.7 million, respectively while related network costs totaled \$2.3 million and \$4.5 million, respectively. On a net basis we reported \$6.7 million and \$13.2 million, respectively, as net interchange and debit card transactions fees as noninterest income for the three and six months ended June 30, 2017. This adoption method is considered a change in accounting principle requiring additional disclosure of the nature of and reason for the change, which is solely a result of the adoption of the required standard. When applying the retrospective approach under ASU Topic 606, the Company has elected, as a practical expedient, to apply the revenue standard only to contracts that are not completed as of January 1, 2018. A completed contract is considered to be

Table of Contents

a contract for which all (or substantially all) of the revenue was recognized in accordance with revenue guidance that was in effect before January 1, 2018. There were no uncompleted contracts as of January 1, 2018 for which application of the new standard required an adjustment to retained earnings.

The following disclosures related to ASU Topic 606 involve income derived from contracts with customers. Within the scope of ASU Topic 606, we maintain contracts to provide services, primarily for investment advisory and/or custody of assets. Through our wholly-owned subsidiaries, the Bank, South State Advisory and Minis, Inc., we contract with our customers to perform IRA, Trust, and/or Custody and Agency advisory services. Total revenue recognized from these contracts with customers was \$7.6 million and \$15.1 million, respectively, for the three and six months ended June 30, 2018. The Bank contracts with our customers to perform deposit account services. Total revenue recognized from these contracts with customers is \$25.9 million and \$51.7 million, respectively, for the three and six months ended June 30, 2018. Due to the nature of our relationship with the customers that we provide services, we do not incur costs to obtain contracts and there are no material incremental costs to fulfill these contracts that should be capitalized.

Disaggregation of Revenue - Our portfolio of services provided to our customers consists of over 803,000 active contracts. We have disaggregated revenue according to timing of the transfer of service. Total revenue derived from contracts in which services are transferred at a point in time was \$32.9 million and \$66.7 million, respectively, for the three and six months ended June 30, 2018. Total revenue derived from contracts in which services are transferred over time was \$4.9 million and \$9.8 million, respectively, for the three and six months ended June 30, 2018. Revenue is recognized as the services are provided to the customers. Economic factors impacting the customers could affect the nature, amount, and timing of these cash flows, as unfavorable economic conditions could impair the customers' ability to provide payment for services. This risk is mitigated as we generally deduct payments from customers' accounts as services are rendered.

Contract Balances - The timing of revenue recognition, billings, and cash collections results in billed accounts receivable on our balance sheet. Most contracts call for payment by a charge or deduction to the respective customer account but there are some that require a receipt of payment from the customer. For fee per transaction contracts, the customers are billed as the transactions are processed. For hourly rate and monthly service contracts related to trust and some investment revenues, the customers are billed monthly (generally as a percentage basis point of the market value of the investment account). In some cases, specific to Minis, Inc. and South State Advisory, customers are billed in advance for quarterly services to be performed based on the past quarter's average account balance. These do create contract liabilities or deferred revenue, as the customers pay in advance for service. Neither the contract liabilities nor the accounts receivables balances are material to the Company's balance sheet.

Performance Obligations - A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in ASU Topic 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The performance obligations for these contracts are satisfied as the service is provided to the customer (either over time or at a point in time). The payment terms of the contracts are typically based on a basis point percentage of the investment account market value, fee per hour of service, or fee for service incurred. There are no significant

financing components in the contracts. Excluding deposit services revenues which are mostly billed at a point in time as a fee for services incurred, all other contracts within the scope of ASU Topic 606 contain variable consideration in that fees earned are derived from market values of accounts or from hours worked for services performed which determines the amount of consideration to which we are entitled. The variability is resolved when the hours are incurred or services are provided. The contracts do not include obligations for returns, refunds, or warranties. The contracts are specific to the amounts owed to the Company for services performed during a period should the contracts be terminated.

Significant Judgements - All of the contracts create performance obligations that are satisfied at a point in time excluding the contracts billed in advance through Minis and South State Advisory and some immaterial deposit revenues. Revenue is recognized as services are billed to the customers. Variable consideration does exist for contracts related to our trust and investment services as revenues are based on market values and services performed. We have adopted the right-to-invoice practical expedient for trust management contracts through South State Bank which we contract with our customers to perform IRA, Trust, and/or Custody services.

Table of Contents

Note 3 — Recent Accounting and Regulatory Pronouncements

In February 2018, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2018-03, Technical Corrections and Improvements to Financial Instruments-Overall (Subtopic 825-10) (“ASU 2018-03”). ASU 2018-03 updates the new financial instruments standard by clarifying issues that arose from ASU 2016-01, but does not change the core principle of the new standard. The issues addressed in this ASU include: (1) Equity securities without a readily determinable fair value-discontinuation, (2) Equity securities without a readily determinable fair value-adjustments, (3) Forward contracts and purchased options, (4) Presentation requirements for certain fair value option liabilities, (5) Fair value option liabilities denominated in a foreign currency, (6) Transition guidance for equity securities without a readily determinable fair value, and (7) Transition and open effective date information. For public business entities, the amendments in ASU 2018-03 and ASU 2016-01 are effective for interim and annual periods beginning after December 15, 2017. An entity should apply the amendments by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption of ASU 2018-03 and ASU 2016-01. This guidance became effective on January 1, 2018 and the Company determined that the implementation of this standard did not have a material impact to the Company’s consolidated financial statements.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (“ASU 2018-02”). ASU 2018-02 amends ASC Topic 220 and allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 (the “Tax Reform Act”). Consequently, this amendment eliminates the stranded tax effects resulting from the Tax Reform Act and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Reform Act, the underlying guidance that requires that the effects of the change in tax laws or rates be included in income from continuing operations is not affected. The guidance is effective for public companies for annual periods beginning on or after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period, (1) for public business entities for reporting periods for which financial statements have not yet been issued and (2) for all other entities for reporting periods for which financial statements have not yet been made available for issuance. This amendment should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in U.S. federal corporate income tax rate in the Tax Reform Act is recognized. The Company early adopted this amendment in the first quarter of 2018 and reclassified \$2.9 million from accumulated other comprehensive income to retained earnings for the stranded tax effects resulting from the Tax Reform Act.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities (“ASU 2017-12”). ASU 2017-12 amends Accounting Standards Codification (“ASC”) Topic 815 to better align an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. These amendments will improve the transparency of information about an entity’s risk management activities and simplify the application of hedge accounting. The guidance is effective for public companies for annual periods beginning on or after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. All transition requirements and elections should be applied to hedging relationships existing on the date of adoption. The Company is still assessing the impact of this new guidance, but does not believe it will have a material impact on the Company’s consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting (“ASU 2017-09”). ASU 2017-09 provides clarity by offering guidance on the scope of modification accounting for share-based payment awards and gives direction on which changes to the terms or conditions of these awards require an entity to apply modification accounting. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or a liability) changes as a result of the change in terms or conditions. The guidance is effective prospectively for all companies for annual periods beginning on or after December 15, 2017. Early adoption is permitted. The Company adopted this standard in the first quarter of 2018 and determined that this guidance did not have a material impact on the Company’s consolidated financial statements.

Table of Contents

In March 2017, the FASB issued ASU No. 2017-08, Receivables-Nonrefundable Fees and Other Cost (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities; (“ASU 2017-08”). ASU 2017-08 shortens the amortization period of the premium for certain callable debt securities, from the contractual maturity date to the earliest call date. The amendments do not require an accounting change for securities held at a discount; an entity will continue to amortize to the contractual maturity date the discount related to callable debt securities. The amendments apply to the amortization of premiums on callable debt securities with explicit, noncontingent call features that are callable at fixed prices on preset dates. For public business entities, ASU 2017-08 is effective in fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. For entities other than public business entities, the amendments are effective in fiscal years beginning after December 15, 2019 and in interim periods in fiscal years beginning after December 15, 2020. Early adoption is permitted for all entities, including in an interim period. The amendments should be applied on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the amendments are adopted. The Company has determined that this guidance will not have a material impact on the Company’s consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (“ASU 2017-07”). ASU 2017-07 applies to any employer that sponsors a defined benefit pension plan, other postretirement benefit plan, or other types of benefits accounted for under Topic 715. The amendments require that an employer disaggregate the service cost component from the other components of net benefit cost, as follows (1) service cost must be presented in the same line item(s) as other employee compensation costs, which costs are generally included within income from continuing operations, but in some cases may be eligible for capitalization, (2) all other components of net benefit cost must be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented, and (3) the amendments permit capitalizing only the service cost component of net benefit cost, assuming such costs meet the criteria required for capitalization by other GAAP, rather than total net benefit cost which has been permitted under prior GAAP. The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those years. The amendments should be adopted prospectively and allows a practical expedient that permits an employer to use the amounts disclosed in its pension and other postretirement benefit plan note for the prior periods to apply the retrospective presentation requirements. The Company adopted this standard in the first quarter of 2018 and determined that this guidance did not have a material impact on the Company’s consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangible-Goodwill and other (Topic 350): Simplifying the Test for Goodwill Impairment (“ASU 2017-04”). ASU 2017-04 simplifies the accounting for goodwill impairment for all entities by requiring impairment charges to be based on the first step in today’s two-step impairment test under ASC Topic 350 and eliminating Step 2 from the goodwill impairment test. As amended, the goodwill impairment test will consist of one step comparing the fair value of a reporting unit with its carrying amount. An entity should recognize a goodwill impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value. The guidance is effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those years. The amendments should be adopted prospectively and early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. At this point in time, the Company does not expect that this guidance will have a material impact on the Company’s consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business (“ASU 2017-01”). These amendments are intended to clarify the definition of a business to assist companies and other reporting entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 requires an entity to evaluate if substantially all of the fair value of the gross assets acquired are concentrated in a single identifiable asset or a group of similar identifiable assets; if so,

the set of transferred assets and activities is not a business. The guidance also requires a business to include at least one substantive process and narrows the definition of outputs by more closely aligning it with how outputs are described in ASC Topic 606. The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted. The Company adopted this standard in the first quarter of 2018 and determined that this guidance did not have a material impact on the Company's consolidated financial statements.

In December 2016, the FASB issued ASU No. 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers ("ASU 2016-20"). ASU 2016-20 updates the new revenue standard by clarifying issues that arose from ASU 2014-09, but does not change the core principle of the new standard. The issues

Table of Contents

addressed in this ASU include: (1) Loan guarantee fees, (2) Impairment testing of contract costs, (3) Interaction of impairment testing with guidance in other topics, (4) Provisions for losses on construction-type and production-type contracts, (5) Scope of topic 606, (6) Disclosure of remaining performance obligations, (7) Disclosure of prior-period performance obligations, (8) Contract modifications, (9) Contract asset vs. receivable, (10) Refund liability, (11) Advertising costs, (12) Fixed-odds wagering contracts in the casino industry, (13) Cost capitalization for advisors to private funds and public funds. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this new guidance recognized at the date of initial application. The Company's revenue includes net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and non-interest income. ASU 2016-20, ASU 2016-08 and ASU 2014-09 became effective on January 1, 2018 and the Company refined its disclosures around the standard in the first quarter of 2018. See Note 2 – Summary of Significant Accounting Policies for additional information. The Company has determined that there is no material change on how the Company recognizes its revenue streams and the adoption of these standards did not have a material impact on the Company's consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). ASU 2016-15 addresses eight classification issues related to the statement of cash flows: Debt prepayment or debt extinguishment costs; Settlement of zero-coupon bonds; Contingent consideration payments made after a business combination; Proceeds from the settlement of insurance claims; Proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; Distributions received from equity method investees; Beneficial interests in securitization transactions; and Separately identifiable cash flows and application of the predominance principle. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. Entities will apply the standard's provisions using a retrospective transition method to each period presented. The Company adopted this standard in the first quarter of 2018 and determined that this guidance did not have a material impact on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"). ASU 2016-13 requires an entity to utilize a new impairment model known as the current expected credit loss ("CECL") model to estimate its lifetime "expected credit loss" and record an allowance that, when deducted from the amortized cost basis of the financial asset, presents the net amount expected to be collected on the financial asset. The CECL model is expected to result in earlier recognition of credit losses. ASU 2016-13 also requires new disclosures for financial assets measured at amortized cost, loans and available-for-sale debt securities. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company has dedicated staff and resources in place evaluating the Company's options including evaluating the appropriate model options and collecting and reviewing loan data for use in these models. The Company is currently still assessing the impact that this new guidance will have on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent considerations (Reporting Revenue Gross versus Net) ("ASU 2016-08"). ASU 2016-08 updates the new revenue standard by clarifying the principal versus agent implementation guidance, but does not change the core principle of the new standard. The updates to the principal versus agent guidance: (i) require an entity to determine whether it is a principal or an agent for each distinct good or service (or a distinct bundle of goods or services) to be provided to the customer; (ii) illustrate how an entity that is a principal might apply the control principle to goods, services, or rights to services, when another party is involved in providing goods or services to a customer and (iii) Clarify that the purpose of certain specific control indicators is to support or assist in the assessment of whether an

entity controls a good or service before it is transferred to the customer, provide more specific guidance on how the indicators should be considered, and clarify that their relevance will vary depending on the facts and circumstances. For public business entities, the effective date and transition requirements for these amendments are the same as the effective date and transition requirements of ASU 2014-09 which is effective for interim and annual periods beginning after December 15, 2017. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this new guidance recognized at the date of initial application. The Company's revenue includes net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and non-interest income. ASU 2016-20, ASU 2016-08 and ASU 2014-09 became effective on

Table of Contents

January 1, 2018 and the Company refined its disclosures around the standard in the first quarter of 2018. The Company determined that there is no material change on how the Company recognizes its revenue streams and the adoption of these standards did not have a material impact on the Company's consolidated financial statements, other than the required disclosures and the reclassification of interchange costs from noninterest expense to noninterest income on the Consolidated Statement of Income which the Company applied retrospectively to each prior reporting period. See further discussion in Note 2 – Summary of Significant Accounting Policies.

In March 2016, the FASB issued ASU No. 2016-05, Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships ("ASU 2016-05"). ASU 2016-05 requires an entity to discontinue a designated hedging relationship in certain circumstances, including termination of the derivative hedging instrument or if the entity wishes to change any of the critical terms of the hedging relationship. ASU 2016-05 amends Topic 815 to clarify that novation of a derivative (replacing one of the parties to a derivative instrument with a new party) designated as the hedging instrument would not, in and of itself, be considered a termination of the derivative instrument or a change in critical terms requiring discontinuation of the designated hedging relationship. For public business entities, the amendments in ASU 2016-05 are effective for interim and annual periods beginning after December 15, 2016. An entity has an option to apply the amendments in ASU 2016-05 on either a prospective basis or a modified retrospective basis. ASU 2016-05 became effective for the Company on January 1, 2017 and did not have a significant impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"). ASU 2016-02 applies a right-of-use (ROU) model that requires a lessee to record, for all leases with a lease term of more than 12 months, an asset representing its right to use the underlying asset and a liability to make lease payments. For leases with a term of 12 months or less, a practical expedient is available whereby a lessee may elect, by class of underlying asset, not to recognize an ROU asset or lease liability. At inception, lessees must classify all leases as either finance or operating based on five criteria. Balance sheet recognition of finance and operating leases is similar, but the pattern of expense recognition in the income statement, as well as the effect on the statement of cash flows, differs depending on the lease classification. For public business entities, the amendments in ASU 2016-02 are effective for interim and annual periods beginning after December 15, 2018. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach which includes a number of optional practical expedients that entities may elect to apply. The Company has reviewed its outstanding lease agreements and has centrally documented the terms of its leases. The Company is still currently evaluating the provisions of ASU 2016-02 in relation to its outstanding leases to determine the potential impact the new standard will have to the Company's consolidated financial statements. Based on the Company's current evaluation, the Company estimates that it would have recorded a right to use asset and a lease liability of approximately \$78 million if the standard was effective at June 30, 2018.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10); Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). This update is intended to improve the recognition and measurement of financial instruments and it requires an entity to: (i) measure equity investments at fair value through net income, with certain exceptions; (ii) present in OCI the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; (iii) present financial assets and financial liabilities by measurement category and form of financial asset; (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price; and (v) assess a valuation allowance on deferred tax assets related to unrealized losses of AFS debt securities in combination with other deferred tax assets. ASU 2016-01 also provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes and requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. For public business entities, the amendments in ASU 2016-01 are effective for interim and annual periods beginning after December 15, 2017. An entity should apply the amendments by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of

adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption of the ASU 2016-01. This guidance became effective on January 1, 2018 and the Company has determined that the implementation of this standard did not have a material impact to the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, Topic 606 ("ASU 2014-09"). The new standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in

Table of Contents

exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under existing guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In August of 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers, Topic 606: Deferral of the Effective Date, deferring the effective date of ASU 2014-09 until annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this new guidance recognized at the date of initial application. The Company's revenue includes net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and non-interest income. ASU 2016-20, ASU 2016-08 and ASU 2014-09 became effective on January 1, 2018 and the Company refined its disclosures around the standard in the first quarter of 2018. See Note 2 – Summary of Significant Accounting Policies for additional information. The Company has determined that there is no material change on how the Company recognizes its revenue streams and the adoption of these standards did not have a material impact on the Company's consolidated financial statements.

Note 4 — Mergers and Acquisitions

The following business combinations have occurred over the past two years:

- Park Sterling Corporation (“PSC” or “Park”) – November 30, 2017 – Whole bank acquisition
- Southeastern Bank Financial Corporation (“SBFC” or “Southeastern”) – January 3, 2017 – Whole bank acquisition

Park Sterling Corporation Acquisition

On November 30, 2017, SSB acquired all of the outstanding common stock of PSC of Charlotte, North Carolina, the bank holding company for Park Sterling Bank (“PSB”), in a stock transaction. PSC common shareholders received 0.14 shares of the SSB's common stock in exchange for each share of PSC stock resulting in SSB issuing 7,480,343 shares of common stock. In total, the purchase price for PSC was \$693.0 million including the value of “in the money” outstanding stock options totaling \$4.3 million.

The PSC transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date. The following table presents the assets acquired and liabilities assumed as of November 30, 2017 and their initial and subsequent fair value estimates, as recorded by the Company. Fair values are preliminary and subject to refinement for up to a year after the closing date of the acquisition for new information obtained about facts and circumstances that existed at the acquisition date.

Table of Contents

(Dollars in thousands)	As Recorded by Park	Initial Fair Value Adjustments		Subsequent Fair Value Adjustments	As Recorded by the Company
Assets					
Cash and cash equivalents	\$ 116,454	\$ —		\$ —	\$ 116,454
Investment securities	461,261	1,444	(a)	219	(a) 462,924
Loans held for sale	2,200	68,686	(b)	(4)	(b) 70,882
Loans, net of allowance and mark	2,346,612	(95,878)	(c)	(9,131)	(c) 2,241,603
Premises and equipment	61,059	(4,882)	(d)	(387)	(d) 55,790
Intangible assets	73,090	(46,915)	(e)	3,321	(e) 29,496
OREO and repossessed assets	2,549	(429)	(f)	210	(f) 2,330
Bank owned life insurance	72,703	—		—	72,703
Deferred tax asset	17,963	11,596	(g)	2,025	(g) 31,584
Other assets	21,595	(476)	(h)	—	21,119
Total assets	\$ 3,175,486	\$ (66,854)		\$ (3,747)	\$ 3,104,885
Liabilities					
Deposits:					
Noninterest-bearing	\$ 561,874	\$ —		\$ —	\$ 561,874
Interest-bearing	1,886,810	2,692	(i)	(612)	(i) 1,888,890
Total deposits	2,448,684	2,692		(612)	2,450,764
Federal funds purchased and securities sold under agreements to repurchase	—	—		—	—
Other borrowings	329,249	11,689	(j)	—	340,938
Other liabilities	24,179	2,131	(k)	—	26,310
Total liabilities	2,802,112	16,512		(612)	2,818,012
Net identifiable assets acquired over (under) liabilities assumed	373,374	(83,366)		(3,135)	286,873
Goodwill	—	402,951		3,135	406,086
Net assets acquired over liabilities assumed	\$ 373,374	\$ 319,585		\$ —	\$ 692,959
Consideration:					
South State Corporation common shares issued					7,480,343
Purchase price per share of the SSB's common stock					\$ 92.05
SSB common stock issued (\$688,566) and cash exchanged for fractional shares (\$88)					\$ 688,654
Cash paid for stock option redemptions					4,305
Fair value of total consideration transferred					\$ 692,959

Explanation of fair value adjustments

(a)—Adjustment reflects marking the securities portfolio to fair value as of the acquisition date.

Edgar Filing: SOUTH STATE Corp - Form 10-Q

(b)—Adjustment reflects a reclassification of \$68.7 million by SSB of Shared National Credits (loans) from loans held for investment to loans held for sale.

(c)—Adjustment reflects the fair value adjustments (discount) of \$70.1 million based on the Company's evaluation of the acquired loan portfolio. This amount excludes the allowance for loan losses ("ALLL") and fair value adjustment (discount) of \$12.5 million and \$21.3 million, respectively, recorded by PSC and is net of the \$68.7 million reclassification related to the Shared National Credits noted in (b), above.

(d)—Adjustment reflects the fair value adjustments based on the Company's evaluation of the acquired premises and equipment.

(e)—Adjustment reflects the recording of a 1.66% Core Deposit Intangible ("CDI") on the acquired deposit accounts that totaled \$29.5 million offset by a write-off of \$73.1 million of existing goodwill and CDI acquired from PSC.

(f)—Adjustment reflects the fair value adjustments to other real estate owned ("OREO") based on the Company's evaluation of the acquired OREO portfolio.

(g)—Adjustment to record deferred tax asset related to the fair value adjustments and an adjustment from the PSC tax rate to the SSB tax rate.

Table of Contents

- (h)—Adjustment reflects the write-off of accrued interest receivable along with certain prepaid expenses.
- (i)—Adjustment reflects the premium for fixed maturity time deposits of \$2.3 million offset by the write-off of existing fair value marks of \$253,000 acquired from PSC.
- (j)—Adjustment reflects the fair value adjustment (discount) of \$2.4 million on PSC’s Trust Preferred Securities offset by the write-off of the existing PSC discount on its senior debt and TRUPs of \$14.0 million.
- (k)—Adjustment reflects the fair value adjustments to employee benefit plans of \$1.5 million along with other adjustments of miscellaneous liabilities.

Comparative and Pro Forma Financial Information for the PSC Acquisition

The adjusted results of the Company for the periods ended June 30, 2018, include the adjusted results of the acquired assets and assumed liabilities since the acquisition date of November 30, 2017 related to the PSC acquisition. Merger-related charges of \$14.1 million and \$25.4 million, respectively, are recorded in the consolidated statement of income for the three and six months ended June 30, 2018; and include incremental costs related to the conversion of systems, termination of contracts, branch closures and severance cost.

The following table discloses the impact of the merger with PSC (excluding the impact of merger-related expenses) for the three and six months ended June 30, 2018. The table also presents certain pro forma information as if PSC had been acquired on January 1, 2017. These results combine the historical results of PSC in the Company’s consolidated statement of income and, while certain adjustments were made for the estimated impact of certain fair value adjustments and other acquisition-related activity, they are not indicative of what would have occurred had the acquisition taken place on January 1, 2017.

Merger-related costs of \$4.3 million and \$21.0 million from the SBFC acquisition were incurred during the three and six months ended June 30, 2017 and were excluded from the pro forma information below. In addition, no adjustments have been made to the pro formas to eliminate the provision for loan losses for the three and six months ended June 30, 2017 of PSC in the amount of \$0 and \$678,000, respectively. No adjustments have been made to reduce the impact of any OREO write downs, investment securities sold or repayment of borrowings recognized by PSC in the three and six months ended June 30, 2017. Expenses related to systems conversions, contract cancellation and personnel are expected to continue to be recorded in the third quarter of 2018 for the PSC merger. The Company expects to achieve operating cost savings and other business synergies as a result of the acquisitions which are not reflected in the pro forma amounts below:

	PSC		PSC	
	Estimated/Actual	Pro Forma	Estimated/Actual	Pro Forma
	For the Three	Three	For the Six	
	Months	Months	Months	Six Months
	Ended June 30,	Ended June	Ended June 30,	Ended June
	2018	30, 2017	2018	30, 2017
(Dollars in thousands)	\$ 29,924	\$ 172,902	\$ 66,088	\$ 337,728

Total revenues (net interest income plus
noninterest income)

Net adjusted income available to the common
shareholder

\$ 15,656	\$ 46,764	\$ 35,054	\$ 88,843
-----------	-----------	-----------	-----------

Southeastern Bank Financial Corporation Acquisition

On January 3, 2017, SSB acquired all of the outstanding common stock of SBFC of Augusta, Georgia, the bank holding company for Georgia Bank & Trust Company of Augusta (“GB&T”), in a stock transaction. SBFC common shareholders received 0.7307 shares of SSB’s common stock in exchange for each share of SBFC stock resulting in SSB issuing 4,978,338 shares of common stock. In total, the purchase price for SBFC was \$435.1 million including the value of “in the money” outstanding stock options totaling \$490,000.

The SBFC transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date.

The following table presents the assets acquired and liabilities assumed as of January 3, 2017 at their initial and subsequent fair value estimates, as recorded by the Company. The fair value estimates were subject to refinement for up

Table of Contents

to one year after the closing date of the acquisition for new information obtained about facts and circumstances that existed at the acquisition date.

(Dollars in thousands)	As Recorded by SBFC	Initial Fair Value Adjustments		Subsequent Fair Value Adjustments	As Recorded by the Company
Assets					
Cash and cash equivalents	\$ 72,043	\$ —		\$ —	\$ 72,043
Investment securities	591,824	(1,770)	(a)	—	590,054
Loans held for sale	13,652	—		—	13,652
Loans, net of allowance and mark	1,060,618	(10,668)	(b)	—	1,049,950
Premises and equipment	25,419	(2,212)	(c)	870	(c)
Intangible assets	140	17,980	(d)	—	18,120
OREO and repossessed assets	580	(30)	(e)	(100)	(e)
Bank owned life insurance	44,513	—		—	44,513
Deferred tax asset	16,247	(687)	(f)	515	(f)
Other assets	7,545	(482)	(g)	—	7,063
Total assets	\$ 1,832,581	\$ 2,131		\$ 1,285	\$ 1,835,997
Liabilities					
Deposits:					
Noninterest-bearing	\$ 262,967	\$ —		\$ —	\$ 262,967
Interest-bearing	1,257,953	—		—	1,257,953
Total deposits	1,520,920	—		—	1,520,920
Federal funds purchased and securities sold under agreements to repurchase	1,014	—		—	1,014
Other borrowings	110,620	(1,120)	(h)	—	109,500
Other liabilities	19,980	5,553	(i)	2,210	(i)
Total liabilities	1,652,534	4,433		2,210	1,659,177
Net identifiable assets acquired over (under) liabilities assumed	180,047	(2,302)		(925)	176,820
Goodwill	—	257,370		925	258,295
Net assets acquired over liabilities assumed	\$ 180,047	\$ 255,068		\$ —	\$ 435,115
Consideration:					
South State Corporation common shares issued					4,978,338
Purchase price per share of the Company's common stock					\$ 87.30
Company common stock issued (\$434,609) and cash exchanged for fractional shares (\$16)					\$ 434,625
Cash paid for stock option redemptions					490
Fair value of total consideration transferred					\$ 435,115

Explanation of fair value adjustments

- (a)—Adjustment reflects marking the securities portfolio to fair value as of the acquisition date.
- (b)—Adjustment reflects the fair value adjustments of \$30.7 million based on the Company's evaluation of the acquired loan portfolio and excludes the ALLL of \$20.1 million recorded by SBFC.
- (c)—Adjustment reflects the fair value adjustments based on the Company's evaluation of the acquired premises and equipment.
- (d)—Adjustment reflects the recording of the core deposit intangible on the acquired deposit accounts that totaled \$18.1 million.
- (e)—Adjustment reflects the fair value adjustments to OREO and repossessed assets based on the Company's evaluation of the acquired OREO and repossessed assets portfolio.
- (f)—Adjustment to record deferred tax asset related to the fair value adjustments.
- (g)—Adjustment reflects uncollectible portion of accrued interest receivable and loan fees receivable along with the write-off of certain prepaid expenses.

Table of Contents

(h)—Adjustment reflects the fair value adjustments based on the Company’s evaluation of other borrowings of Trust Preferred Securities with a discount of \$2.1 million, netted with premium on certain Federal Home Loan Bank (“FHLB”) advances of \$1.0 million.

(i)—Adjustment reflects the fair value adjustments to employee benefit plans of \$8.3 million netted against an adjustment of other miscellaneous liabilities of \$496,000.

Note 5 — Investment Securities

The following is the amortized cost and fair value of investment securities held to maturity:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2018:				
State and municipal obligations	\$ 499	\$ 4	\$ —	\$ 503
December 31, 2017:				
State and municipal obligations	\$ 2,529	\$ 27	\$ —	\$ 2,556
June 30, 2017:				
State and municipal obligations	\$ 4,166	\$ 82	\$ —	\$ 4,248

The following is the amortized cost and fair value of investment securities available for sale:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2018:				
Government-sponsored entities debt*	\$ 48,933	\$ —	\$ (1,320)	\$ 47,613
State and municipal obligations	223,533	1,932	(1,649)	223,816
Mortgage-backed securities**	1,342,105	110	(35,645)	1,306,570
Corporate securities	—	—	—	—
	\$ 1,614,571	\$ 2,042	\$ (38,614)	\$ 1,577,999
December 31, 2017:				
Government-sponsored entities debt*	\$ 86,535	\$ 51	\$ (1,077)	\$ 85,509
State and municipal obligations	216,812	3,749	(124)	220,437
Mortgage-backed securities**	1,350,200	2,103	(11,616)	1,340,687

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Corporate securities	1,560	—	—	1,560
	\$ 1,655,107	\$ 5,903	\$ (12,817)	\$ 1,648,193
June 30, 2017:				
Government-sponsored entities debt*	\$ 76,508	\$ 52	\$ (608)	\$ 75,952
State and municipal obligations	188,720	4,680	(106)	193,294
Mortgage-backed securities**	1,068,718	5,195	(5,316)	1,068,597
Corporate stocks	2,433	550	(399)	2,584
	\$ 1,336,379	\$ 10,477	\$ (6,429)	\$ 1,340,427

* - The Company's government-sponsored entities holdings are comprised of debt securities offered by Federal Home Loan Mortgage Corporation ("FHLMC") or Freddie Mac, Federal National Mortgage Association ("FNMA") or Fannie Mae, FHLB, and Federal Farm Credit Banks ("FFCB").

** - All of the mortgage-backed securities are issued by government-sponsored entities; there are no private-label holdings. Also, included in the Company's mortgage-backed securities are debt securities offered by the Small Business Administration ("SBA"), which have the full faith and credit backing of the United States Government.

Table of Contents

The following is the amortized cost and fair value of other investment securities:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2018:				
Federal Home Loan Bank stock	\$ 13,149	\$ —	\$ —	\$ 13,149
Investment in unconsolidated subsidiaries	3,563	—	—	3,563
Other nonmarketable investment securities	2,517	—	—	2,517
	\$ 19,229	\$ —	\$ —	\$ 19,229
December 31, 2017:				
Federal Home Loan Bank stock	\$ 16,967	\$ —	\$ —	\$ 16,967
Investment in unconsolidated subsidiaries	3,563	—	—	3,563
Other nonmarketable investment securities	2,517	—	—	2,517
	\$ 23,047	\$ —	\$ —	\$ 23,047
June 30, 2017:				
Federal Home Loan Bank stock	\$ 10,814	\$ —	\$ —	\$ 10,814
Investment in unconsolidated subsidiaries	2,262	—	—	2,262
Other nonmarketable investment securities	1,225	—	—	1,225
	\$ 14,301	\$ —	\$ —	\$ 14,301

The amortized cost and fair value of debt securities at June 30, 2018 by contractual maturity are detailed below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.

(Dollars in thousands)	Securities Held to Maturity		Securities Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ —	\$ —	\$ 2,701	\$ 2,703
Due after one year through five years	—	—	82,771	82,207
Due after five years through ten years	499	503	391,946	383,572
Due after ten years	—	—	1,137,153	1,109,517
	\$ 499	\$ 503	\$ 1,614,571	\$ 1,577,999

Table of Contents

Information pertaining to the Company's securities with gross unrealized losses at June 30, 2018, December 31, 2017 and June 30, 2017, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position is as follows:

(Dollars in thousands)	Less Than Twelve Months Gross Unrealized		Twelve Months or More Gross Unrealized	
	Losses	Fair Value	Losses	Fair Value
June 30, 2018:				
Securities Available for Sale				
Government-sponsored entities debt	\$ 1,179	\$ 39,145	\$ 141	\$ 8,468
State and municipal obligations	1,617	77,373	32	1,348
Mortgage-backed securities	21,494	946,142	14,151	331,871
Corporate securities	—	—	—	—
	\$ 24,290	\$ 1,062,660	\$ 14,324	\$ 341,687
December 31, 2017:				
Securities Available for Sale				
Government-sponsored entities debt	\$ 403	\$ 27,442	\$ 674	\$ 52,324
State and municipal obligations	124	17,400	—	—
Mortgage-backed securities	4,493	610,051	7,123	322,258
Corporate securities	—	—	—	—
	\$ 5,020	\$ 654,893	\$ 7,797	\$ 374,582
June 30, 2017:				
Securities Available for Sale				
Government-sponsored entities debt	\$ 608	\$ 70,226	\$ —	\$ —
State and municipal obligations	106	9,171	—	—
Mortgage-backed securities	5,207	570,625	109	13,854
Corporate stocks	—	—	399	1,333
	\$ 5,921	\$ 650,022	\$ 508	\$ 15,187

Management evaluates securities for other-than-temporary impairment (“OTTI”) on at least a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the financial condition and near-term prospects of the issuer, (2) the outlook for receiving the contractual cash flows of the investments, (3) the length of time and the extent to which the fair value has been less than cost, (4) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value or for a debt security whether it is more-likely-than-not that the Company will be required to sell the debt security prior to recovering its fair value, and (5) the anticipated outlook for changes in the general level of interest rates. All debt securities available for sale in an unrealized loss position as of June 30, 2018 continue to perform as scheduled. As part of the Company's evaluation of its intent and ability to hold investments for a period of time sufficient to allow for any anticipated recovery in the market, the Company considers its investment strategy, cash flow needs, liquidity position, capital adequacy and interest rate risk position. The Company does not currently intend to sell the securities within the portfolio and it is not more-likely-than-not that the Company will be required to sell the debt securities; therefore, management does not consider these investments to be other-than-temporarily impaired at June 30, 2018.

Management continues to monitor all of the Company's securities with a high degree of scrutiny. There can be no assurance that the Company will not conclude in future periods that conditions existing at that time indicate some or all of its securities may be sold or are other than temporarily impaired, which would require a charge to earnings in such periods.

Table of Contents

Note 6 — Loans and Allowance for Loan Losses

The following is a summary of non-acquired loans:

(Dollars in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
Non-acquired loans:			
Commercial non-owner occupied real estate:			
Construction and land development	\$ 906,890	\$ 830,875	\$ 712,242
Commercial non-owner occupied	1,135,235	1,008,893	952,911
Total commercial non-owner occupied real estate	2,042,125	1,839,768	1,665,153
Consumer real estate:			
Consumer owner occupied	1,733,924	1,530,260	1,382,922
Home equity loans	456,946	437,642	411,532
Total consumer real estate	2,190,870	1,967,902	1,794,454
Commercial owner occupied real estate	1,372,453	1,262,776	1,204,953
Commercial and industrial	941,067	815,187	762,583
Other income producing property	205,507	193,847	189,326
Consumer	416,650	378,985	357,761
Other loans	28,867	33,690	18,163
Total non-acquired loans	7,197,539	6,492,155	5,992,393
Less allowance for loan losses	(47,874)	(43,448)	(40,149)
Non-acquired loans, net	\$ 7,149,665	\$ 6,448,707	\$ 5,952,244

The following is a summary of acquired non-credit impaired loans accounted for under FASB ASC Topic 310-20, net of related discount:

(Dollars in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
FASB ASC Topic 310-20 acquired loans:			
Commercial non-owner occupied real estate:			
Construction and land development	\$ 281,282	\$ 403,357	\$ 112,855
Commercial non-owner occupied	752,465	817,166	209,560
Total commercial non-owner occupied real estate	1,033,747	1,220,523	322,415
Consumer real estate:			
Consumer owner occupied	676,596	710,611	520,106
Home equity loans	278,906	320,591	177,129
Total consumer real estate	955,502	1,031,202	697,235
Commercial owner occupied real estate	486,254	521,818	221,566
Commercial and industrial	304,864	398,696	117,884

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Other income producing property	169,392	196,669	83,403
Consumer	126,665	137,710	143,478
Other	—	1,289	—
Total FASB ASC Topic 310-20 acquired loans	\$ 3,076,424	\$ 3,507,907	\$ 1,585,981

The unamortized discount related to the acquired non-credit impaired loans totaled \$43.6 million, \$65.2 million, and \$22.9 million at June 30, 2018, December 31, 2017, and June 30, 2017, respectively.

Table of Contents

In accordance with FASB ASC Topic 310-30, the Company aggregated acquired loans that have common risk characteristics into pools of loan categories as described in the table below. The following is a summary of acquired credit impaired loans accounted for under FASB ASC Topic 310-30 (identified as credit impaired at the time of acquisition), net of related discount:

(Dollars in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
FASB ASC Topic 310-30 acquired loans:			
Commercial real estate	\$ 227,739	\$ 234,595	\$ 214,795
Commercial real estate—construction and development	40,951	49,649	52,977
Residential real estate	229,502	260,787	256,602
Consumer	45,633	51,453	56,362
Commercial and industrial	12,580	26,946	25,486
Total FASB ASC Topic 310-30 acquired loans	556,405	623,430	606,222
Less allowance for loan losses	(4,426)	(4,627)	(3,741)
FASB ASC Topic 310-30 acquired loans, net	\$ 551,979	\$ 618,803	\$ 602,481

The table below reflects refined contractual loan payments (principal and interest), estimates of the amounts not expected to be collected (non-accretable difference), accretable yield (interest income recognized over time), and the resulting fair values at the acquisition date for PSC (November 30, 2017) for loans accounted for using FASB ASC Topic 310-30. During the second quarter of 2018, the initial fair value of loans at acquisition were adjusted to reflect movement of loans between the ASC Topic 310-20 portfolio and the ASC Topic 310-30 portfolio and the movement in interest rates from the initial valuation.

(Dollars in thousands)	November 30, 2017 Loans Impaired at Acquisition
Contractual principal and interest	\$ 113,584
Non-accretable difference	(27,248)
Cash flows expected to be collected	86,336
Accretable difference	(7,369)
Carrying value	\$ 78,967

The table above excludes \$2.1 billion (\$2.2 billion in contractual principal less a \$46.5 million fair value adjustment) in acquired loans at fair value that were identified as either performing with no discount related to the credit or as revolving lines of credit (commercial or consumer) as of the acquisition date and will be accounted for under FASB ASC Topic 310-20.

The table below reflects refined contractual loan payments (principal and interest), estimates of the amounts not expected to be collected (non-accretable difference), accretable yield (interest income recognized over time), and the resulting fair values at the acquisition date for SBFC (January 3, 2017) for loans accounted for using FASB ASC Topic 310-30. During the third quarter of 2017, the initial fair values of the acquired loan portfolios were adjusted to reflect movement of loans between the ASC Topic 310-20 portfolio and the ASC Topic 310-30 portfolio

	January 3, 2017
	Loans Impaired at Acquisition
(Dollars in thousands)	
Contractual principal and interest	\$ 78,963
Non-accretable difference	(13,072)
Cash flows expected to be collected	65,891
Accretable difference	(4,910)
Carrying value	\$ 60,981

The table above excludes \$986.5 million (\$1.0 billion in contractual principal less a \$18.8 million fair value adjustment) in acquired loans at fair value that were identified as either performing with no discount related to the credit or as revolving lines of credit (commercial or consumer) as of the acquisition date and will be accounted for under FASB ASC Topic 310-20.

Table of Contents

Contractual loan payments receivable, estimates of amounts not expected to be collected, other fair value adjustments and the resulting carrying values of acquired credit impaired loans as of June 30, 2018, December 31, 2017 and June 30, 2017 are as follows:

(Dollars in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
Contractual principal and interest	\$ 721,606	\$ 795,850	\$ 774,471
Non-accretable difference	(43,397)	(39,324)	(28,966)
Cash flows expected to be collected	678,209	756,526	745,505
Accretable yield	(121,804)	(133,096)	(139,283)
Carrying value	\$ 556,405	\$ 623,430	\$ 606,222
Allowance for acquired loan losses	\$ (4,426)	\$ (4,627)	\$ (3,741)

Income on acquired credit impaired loans that are not impaired at the acquisition date but is accounted for under FASB ASC Topic 310.30 is recognized in the same manner as loans impaired at the acquisition date. The remaining nonaccretable difference represents cash flows not expected to be collected.

The following are changes in the carrying value of acquired credit impaired loans:

(Dollars in thousands)	Six Months Ended June 30,	
	2018	2017
Balance at beginning of period	\$ 618,803	\$ 602,546
Fair value of acquired loans	—	55,850
Net reductions for payments, foreclosures, and accretion	(67,025)	(55,569)
Change in the allowance for loan losses on acquired loans	201	(346)
Balance at end of period, net of allowance for loan losses on acquired loans	\$ 551,979	\$ 602,481

The table below reflects refined accretable yield balance for acquired credit impaired loans:

(Dollars in thousands)	Six Months Ended June 30,	
	2018	2017
Balance at beginning of period	\$ 133,096	\$ 155,379
Addition from the SBFC acquisition	—	4,603
PSC acquisition Day 1 adjustment	(1,460)	—
Accretion	(25,195)	(29,511)
Reclass of nonaccretable difference due to improvement in expected cash flows	15,585	9,016

Other changes, net	(222)	(204)
Balance at end of period	\$ 121,804	\$ 139,283

In the second quarter of 2018, the accretable yield balance declined by \$8.1 million as loan accretion (income) of \$12.8 million was recognized. This was partially offset by improved expected cash flows of \$6.4 million during the second quarter of 2018.

Our loan loss policy adheres to GAAP as well as interagency guidance. The ALLL is based upon estimates made by management. We maintain an ALLL at a level that we believe is appropriate to cover estimated credit losses on individually evaluated loans that are determined to be impaired as well as estimated credit losses inherent in the remainder of our loan portfolio. Arriving at the allowance involves a high degree of management judgment and results in a range of estimated losses. We regularly evaluate the adequacy of the allowance through our internal risk rating system, outside credit review, and regulatory agency examinations to assess the quality of the loan portfolio and identify problem loans. The evaluation process also includes our analysis of current economic conditions, composition of the loan portfolio, past due and nonaccrual loans, concentrations of credit, lending policies and procedures, and historical loan loss experience. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on, among other factors, changes in economic conditions in our markets. In addition, as noted above, regulatory agencies, as an integral part of their examination process, periodically review our allowances for losses on loans. These agencies may require management to recognize additions to the allowances based on their judgments about information available to them at the time of their examination. Because of these and other factors, it is

Table of Contents

possible that the allowances for losses on loans may change. The provision for loan losses is charged to expense in an amount necessary to maintain the allowance at an appropriate level.

The ALLL on non-acquired loans consists of general and specific reserves. The general reserves are determined by applying loss percentages to the portfolio that are based on historical loss experience for each class of loans and management's evaluation and "risk grading" of the loan portfolio. Additionally, the general economic and business conditions affecting key lending areas, credit quality trends, collateral values, loan volumes and concentrations, seasoning of the loan portfolio, the findings of internal and external credit reviews and results from external bank regulatory examinations are included in this evaluation. Currently, these adjustments are applied to the non-acquired loan portfolio when estimating the level of reserve required. The specific reserves are determined on a loan-by-loan basis based on management's evaluation of our exposure for each credit, given the current payment status of the loan and the value of any underlying collateral. These are loans classified by management as doubtful or substandard. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. Generally, the need for specific reserve is evaluated on impaired loans, and once a specific reserve is established for a loan, a charge-off of that amount occurs in the quarter subsequent to the establishment of the specific reserve. Loans that are determined to be impaired are provided a specific reserve, if necessary, and are excluded from the calculation of the general reserves.

Beginning with the First Financial Holdings, Inc. acquisition in 2013, the Company segregates the acquired loan portfolio into performing loans ("non-credit impaired) and purchased credit impaired loans. The performing loans and revolving type loans are accounted for under FASB ASC 310-20, with each loan being accounted for individually. The ALLL on these loans will be measured and recorded consistent with non-acquired loans. The acquired credit impaired loans will follow the description in the next paragraph.

In determining the acquisition date fair value of purchased loans, and in subsequent accounting, the Company generally aggregates purchased loans into pools of loans with common risk characteristics. Expected cash flows at the acquisition date in excess of the fair value of loans are recorded as interest income over the life of the loans using a level yield method if the timing and amount of the future cash flows of the pool is reasonably estimable. Subsequent to the acquisition date, increases in cash flows over those expected at the acquisition date are reclassified from the non-accretable difference to accretable yield and recognized as interest income prospectively. Decreases in expected cash flows after the acquisition date are recognized by recording an ALLL. Management analyzes the acquired loan pools using various assessments of risk to determine an expected loss. The expected loss is derived based upon a loss given default based upon the collateral type and/or detailed review by loan officers and the probability of default that is determined based upon historical data at the loan level. All acquired loans managed by Special Asset Management are reviewed quarterly and assigned a loss given default. Acquired loans not managed by Special Asset Management are reviewed twice a year in a similar method to the Company's originated portfolio of loans which follow review thresholds based on risk rating categories. In the fourth quarter of 2015, the Company modified its methodology to a more granular approach in determining loss given default on substandard loans with a net book balance between \$100,000 and \$500,000 by adjusting the loss given default to 90% of the most current collateral valuation based on appraised value. Substandard loans greater than \$500,000 were individually assigned loss given defaults each quarter. Trends are reviewed in terms of accrual status, past due status, and weighted average grade of the loans within each of the accounting pools. In addition, the relationship between the change in the unpaid principal balance and change in the mark is assessed to correlate the directional consistency of the expected loss for each pool.

Table of Contents

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

(Dollars in thousands)	Non-acquired Loans	Acquired Non-Credit Impaired Loans	Acquired Credit Impaired Loans	Total
Three Months Ended June 30, 2018:				
Balance at beginning of period	\$ 45,203	\$ —	\$ 4,084	\$ 49,287
Loans charged-off	(1,240)	(1,183)	—	(2,423)
Recoveries of loans previously charged off (1)	1,051	87	—	1,138
Net charge-offs	(189)	(1,096)	—	(1,285)
Provision for loan losses charged to operations	2,860	1,096	522	4,478
Reduction due to loan removals	—	—	(180)	(180)
Balance at end of period	\$ 47,874	\$ —	\$ 4,426	\$ 52,300
Three Months Ended June 30, 2017:				
Balance at beginning of period	\$ 38,449	\$ —	\$ 4,556	\$ 43,005
Loans charged-off	(1,292)	(501)	—	(1,793)
Recoveries of loans previously charged off (1)	536	72	—	608
Net charge-offs	(756)	(429)	—	(1,185)
Provision for loan losses charged to operations	2,456	429	(572)	2,313
Reduction due to loan removals	—	—	(243)	(243)
Balance at end of period	\$ 40,149	\$ —	\$ 3,741	\$ 43,890

(Dollars in thousands)	Non-acquired Loans	Acquired Non-Credit Impaired Loans	Acquired Credit Impaired Loans	Total
Six Months Ended June 30, 2018:				
Balance at beginning of period	\$ 43,448	\$ —	\$ 4,627	\$ 48,075
Loans charged-off	(2,409)	(1,517)	—	(3,926)
Recoveries of loans previously charged off (1)	1,853	252	—	2,105
Net charge-offs	(556)	(1,265)	—	(1,821)
Provision for loan losses charged to operations	4,982	1,265	685	6,932
Reduction due to loan removals	—	—	(886)	(886)
Balance at end of period	\$ 47,874	\$ —	\$ 4,426	\$ 52,300
Six Months Ended June 30, 2017:				
Balance at beginning of period	\$ 36,960	\$ —	\$ 3,395	\$ 40,355
Loans charged-off	(2,589)	(890)	—	(3,479)
Recoveries of loans previously charged off (1)	1,205	135	—	1,340
Net charge-offs	(1,384)	(755)	—	(2,139)
	4,573	755	692	6,020

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Total provision for loan losses charged to operations

Reduction due to loan removals	—	—	(346)	(346)
Balance at end of period	\$ 40,149	\$ —	\$ 3,741	\$ 43,890

(1) – Recoveries related to acquired credit impaired loans are recorded through other noninterest income on the consolidated statement of income and do not run through the ALLL.

Table of Contents

The following tables present a disaggregated analysis of activity in the allowance for loan losses and loan balances for non-acquired loans:

	Construction & Land Development	Commercial Non-owner Occupied	Commercial Owner Occupied	Consumer Owner Occupied	Home Equity	Commercial & Industrial	Other Income Producing Property	Consumer	Other Loans
	\$ 5,847	\$ 6,798	\$ 8,346	\$ 10,193	\$ 3,237	\$ 6,333	\$ 1,393	\$ 2,899	\$ 157
	—	—	(81)	—	(5)	(59)	—	(1,095)	—
	547	2	25	41	27	199	3	207	—
	(207)	409	317	711	109	238	17	1,060	206
2018	\$ 6,187	\$ 7,209	\$ 8,607	\$ 10,945	\$ 3,368	\$ 6,711	\$ 1,413	\$ 3,071	\$ 363
	\$ 846	\$ 93	\$ 44	\$ 30	\$ 180	\$ 485	\$ 144	\$ 7	\$ —
	\$ 5,341	\$ 7,116	\$ 8,563	\$ 10,915	\$ 3,188	\$ 6,226	\$ 1,269	\$ 3,064	\$ 363
	\$ 42,392	\$ 1,348	\$ 4,750	\$ 5,628	\$ 3,144	\$ 1,834	\$ 3,240	\$ 257	\$ —
	864,498	1,133,887	1,367,703	1,728,296	453,802	939,233	202,267	416,393	28,86
	\$ 906,890	\$ 1,135,235	\$ 1,372,453	\$ 1,733,924	\$ 456,946	\$ 941,067	\$ 205,507	\$ 416,650	\$ 28,86
	\$ 4,649	\$ 5,464	\$ 7,894	\$ 8,108	\$ 3,456	\$ 5,124	\$ 1,345	\$ 2,443	\$ (34)
	(69)	—	—	(62)	(190)	(167)	(7)	(797)	—
	68	7	98	27	21	143	5	167	—
	1,098	693	(453)	496	(40)	43	36	719	(136)
2017	\$ 5,746	\$ 6,164	\$ 7,539	\$ 8,569	\$ 3,247	\$ 5,143	\$ 1,379	\$ 2,532	\$ (170)
	\$ 1,310	\$ 146	\$ 62	\$ 57	\$ 119	\$ 362	\$ 238	\$ 6	\$ —
	\$ 4,436	\$ 6,018	\$ 7,477	\$ 8,512	\$ 3,128	\$ 4,781	\$ 1,141	\$ 2,526	\$ (170)

\$ 30,037	\$ 754	\$ 6,054	\$ 4,575	\$ 2,626	\$ 1,198	\$ 3,641	\$ 235	\$ —
682,205	952,157	1,198,899	1,378,347	408,906	761,385	185,685	357,526	18,16
\$ 712,242	\$ 952,911	\$ 1,204,953	\$ 1,382,922	\$ 411,532	\$ 762,583	\$ 189,326	\$ 357,761	\$ 18,16

(Dollars in thousands)	Construction & Land Development	Commercial Non-owner Occupied	Commercial Owner Occupied	Commercial Owner Occupied	Home Equity	Commercial & Industrial	Other Income Producing Property	Consumer
Six Months Ended June 30, 2018								
Allowance for loan losses:								
Balance,								
December 31, 2017	\$ 5,921	\$ 6,525	\$ 8,128	\$ 9,668	\$ 3,250	\$ 5,488	\$ 1,375	\$ 2,788
Charge-offs	(35)	—	(81)	(4)	(71)	(144)	—	(2,074)
Recoveries	989	4	33	64	128	214	11	410
Provision (benefit)	(688)	680	527	1,217	61	1,153	27	1,947
Balance, June 30, 2018	\$ 6,187	\$ 7,209	\$ 8,607	\$ 10,945	\$ 3,368	\$ 6,711	\$ 1,413	\$ 3,071
Six Months Ended June 30, 2017								
Allowance for loan losses:								
Balance,								
December 31, 2016	\$ 4,091	\$ 4,980	\$ 8,022	\$ 7,820	\$ 3,211	\$ 4,842	\$ 1,542	\$ 2,350
Charge-offs	(474)	—	—	(185)	(224)	(189)	(7)	(1,510)
Recoveries	222	48	105	76	95	233	48	378
Provision (benefit)	1,907	1,136	(588)	858	165	257	(204)	1,314
Balance, June 30, 2017	\$ 5,746	\$ 6,164	\$ 7,539	\$ 8,569	\$ 3,247	\$ 5,143	\$ 1,379	\$ 2,532

Table of Contents

The following tables present a disaggregated analysis of activity in the allowance for loan losses and loan balances for acquired non-credit impaired loans:

(Thousands)	Construction & Land Development	Commercial Non-owner Occupied	Commercial Owner Occupied	Consumer Owner Occupied	Home Equity	Commercial & Industrial	Other Income Producing Property	Consumer	Total
As Ended 8/31/18									
Beginning	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Benefit	(106)	—	(28)	—	(158)	(764)	—	(127)	
Benefit	6	—	—	5	28	2	—	46	
Benefit	100	—	28	(5)	130	762	—	81	
As Ended 8/31/18	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
As Ended 7/31/18	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
As Ended 7/31/18	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
As Ended 7/31/18	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
As Ended 7/31/18	281,282	752,465	486,254	676,596	278,906	304,864	169,392	126,665	
As Ended 7/31/18	\$ 281,282	\$ 752,465	\$ 486,254	\$ 676,596	\$ 278,906	\$ 304,864	\$ 169,392	\$ 126,665	\$ —
As Ended 7/31/18	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
As Ended 7/31/18	—	—	—	303	(664)	—	—	(140)	

Edgar Filing: SOUTH STATE Corp - Form 10-Q

	1	—	—	2	60	1	1	7	
(benefit)	(1)	—	—	(305)	604	(1)	(1)	133	
June 30, 2017	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Annually									
June 30, 2017	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Annually									
June 30, 2017	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Annually									
June 30, 2017	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Annually									
June 30, 2017	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Annually									
June 30, 2017	112,855	209,560	221,566	520,106	177,129	117,884	83,403	143,478	
Annually									
June 30, 2017	\$ 112,855	\$ 209,560	\$ 221,566	\$ 520,106	\$ 177,129	\$ 117,884	\$ 83,403	\$ 143,478	\$ —

(Dollars in thousands)	Construction & Land Development	Commercial Non-owner Occupied	Commercial Owner Occupied	Consumer Owner Occupied	Home Equity	Commercial & Industrial	Other Income Producing Property	Consumer	Total
Six Months Ended June 30, 2018									
Allowance for loan losses:									
Balance, December 31, 2017	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Charge-offs	(107)	—	(28)	(70)	(240)	(807)	—	(265)	(1,517)
Recoveries	7	—	—	62	79	55	—	49	252
Provision (benefit)	100	—	28	8	161	752	—	216	1,265
Balance, June 30, 2018	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Six Months Ended June 30, 2017									
Allowance for loan losses:									
Balance, December 31, 2016	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Charge-offs	—	—	—	(10)	(664)	(2)	—	(214)	(890)
Recoveries	2	—	—	42	69	2	1	19	135
Provision (benefit)	(2)	—	—	(32)	595	—	(1)	195	755
Balance, June 30, 2017	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

Table of Contents

The following tables present a disaggregated analysis of activity in the allowance for loan losses and loan balances for acquired credit impaired loans:

(Dollars in thousands)	Commercial Real Estate	Commercial Real Estate- Construction and Development	Residential Real Estate	Consumer	Commercial and Industrial	Total
Three Months Ended June 30, 2018						
Allowance for loan losses:						
Balance, March 31, 2018	\$ 261	\$ 215	\$ 2,509	\$ 594	\$ 505	\$ 4,084
Provision (benefit) for loan losses	375	390	137	(19)	(361)	522
Reduction due to loan removals	—	(29)	(132)	(3)	(16)	(180)
Balance, June 30, 2018	\$ 636	\$ 576	\$ 2,514	\$ 572	\$ 128	\$ 4,426
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Loans collectively evaluated for impairment	\$ 636	\$ 576	\$ 2,514	\$ 572	\$ 128	\$ 4,426
Loans:*						
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Loans collectively evaluated for impairment	227,739	40,951	229,502	45,633	12,580	556,405
Total acquired credit impaired loans	\$ 227,739	\$ 40,951	\$ 229,502	\$ 45,633	\$ 12,580	\$ 556,405
Three Months Ended June 30, 2017						
Allowance for loan losses:						
Balance, March 31, 2017	\$ 335	\$ 130	\$ 3,108	\$ 589	\$ 394	\$ 4,556
Provision (benefit) for loan losses	(292)	—	(192)	(37)	(51)	(572)
Reduction due to loan removals	(3)	(38)	(175)	(4)	(23)	(243)
Balance, June 30, 2017	\$ 40	\$ 92	\$ 2,741	\$ 548	\$ 320	\$ 3,741
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Loans collectively evaluated for impairment	\$ 40	\$ 92	\$ 2,741	\$ 548	\$ 320	\$ 3,741
Loans:*						
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Loans collectively evaluated for impairment	214,795	52,977	256,602	56,362	25,486	606,222

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Total acquired credit impaired loans	\$ 214,795	\$ 52,977	\$ 256,602	\$ 56,362	\$ 25,486	\$ 606,222
--------------------------------------	------------	-----------	------------	-----------	-----------	------------

(Dollars in thousands)	Commercial Real Estate	Commercial Construction and Real Estate-Development	Residential Real Estate	Consumer	Commercial and Industrial	Total
Six Months Ended June 30, 2018						
Allowance for loan losses:						
Balance, December 31, 2017	\$ 288	\$ 180	\$ 3,553	\$ 461	\$ 145	\$ 4,627
Provision (benefit) for loan losses	361	478	(807)	114	539	685
Reduction due to loan removals	(13)	(82)	(232)	(3)	(556)	(886)
Balance, June 30, 2018	\$ 636	\$ 576	\$ 2,514	\$ 572	\$ 128	\$ 4,426
Six Months Ended June 30, 2017						
Allowance for loan losses:						
Balance, December 31, 2016	\$ 41	\$ 139	\$ 2,419	\$ 558	\$ 238	\$ 3,395
Provision (benefit) for loan losses	—	(3)	559	—	136	692
Reduction due to loan removals	(1)	(44)	(237)	(10)	(54)	(346)
Balance, June 30, 2017	\$ 40	\$ 92	\$ 2,741	\$ 548	\$ 320	\$ 3,741

*— The carrying value of acquired credit impaired loans includes a non-accretable difference which is primarily associated with the assessment of credit quality of acquired loans.

As part of the ongoing monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators, including trends related to (i) the level of classified loans, (ii) net charge-offs, (iii) non-performing loans (see details below), and (iv) the general economic conditions of the markets that we serve.

The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. A description of the general characteristics of the risk grades is as follows:

- Pass—These loans range from minimal credit risk to average, however, still acceptable credit risk.
- Special mention—A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the institution's credit position at some future date.

- Substandard—A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness, or weaknesses, that may jeopardize the liquidation of the debt. A substandard loan is characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.
- Doubtful—A doubtful loan has all of the weaknesses inherent in one classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of the currently existing facts, conditions and values, highly questionable and improbable.

Table of Contents

The following table presents the credit risk profile by risk grade of commercial loans for non-acquired loans:

Thousands)	Construction & Development			Commercial Non-owner Occupied			Commercial Owner Occupied		
	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	
	\$ 895,887	\$ 818,240	\$ 700,200	\$ 1,126,099	\$ 999,049	\$ 939,254	\$ 1,343,624	\$ 1,232,927	
	7,858	8,758	8,133	7,378	7,864	11,437	18,808	23,575	
	3,145	3,877	3,909	1,758	1,980	2,220	10,021	6,274	
	—	—	—	—	—	—	—	—	
	\$ 906,890	\$ 830,875	\$ 712,242	\$ 1,135,235	\$ 1,008,893	\$ 952,911	\$ 1,372,453	\$ 1,262,776	

Thousands)	Commercial & Industrial			Other Income Producing Property			Commercial Total		
	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017
	\$ 923,995	\$ 801,885	\$ 741,605	\$ 198,899	\$ 186,158	\$ 180,830	\$ 4,488,504	\$ 4,038,259	\$ 3,700,000
	8,522	11,130	15,916	4,828	6,034	6,636	47,394	57,361	57,000
	8,550	2,172	5,062	1,780	1,655	1,860	25,254	15,958	25,000
	—	—	—	—	—	—	—	—	—
	\$ 941,067	\$ 815,187	\$ 762,583	\$ 205,507	\$ 193,847	\$ 189,326	\$ 4,561,152	\$ 4,111,578	\$ 3,800,000

The following table presents the credit risk profile by risk grade of consumer loans for non-acquired loans:

Thousands)	Consumer Owner Occupied			Home Equity			Consumer	
	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017
	\$ 1,706,574	\$ 1,502,016	\$ 1,356,469	\$ 443,953	\$ 424,369	\$ 397,857	\$ 415,053	\$ 377,425
	12,566	13,902	13,653	6,805	6,749	7,207	623	313
	14,784	14,342	12,800	6,188	6,524	6,468	974	1,247
	—	—	—	—	—	—	—	—
	\$ 1,733,924	\$ 1,530,260	\$ 1,382,922	\$ 456,946	\$ 437,642	\$ 411,532	\$ 416,650	\$ 378,985

Pass	Other		Consumer Total			
	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017
	\$ 28,867	\$ 33,690	\$ 18,163	\$ 2,594,447	\$ 2,337,500	\$ 2,128,733

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Special mention	—	—	—	19,994	20,964	21,208
Substandard	—	—	—	21,946	22,113	20,437
Doubtful	—	—	—	—	—	—
	\$ 28,867	\$ 33,690	\$ 18,163	\$ 2,636,387	\$ 2,380,577	\$ 2,170,378

The following table presents the credit risk profile by risk grade of total non-acquired loans:

(Dollars in thousands)	Total Non-acquired Loans		
	June 30, 2018	December 31, 2017	June 30, 2017
Pass	\$ 7,082,951	\$ 6,375,759	\$ 5,868,309
Special mention	67,388	78,325	78,334
Substandard	47,200	38,071	45,750
Doubtful	—	—	—
	\$ 7,197,539	\$ 6,492,155	\$ 5,992,393

The following table presents the credit risk profile by risk grade of commercial loans for acquired non-credit impaired loans:

Construction & Development	Commercial Non-owner Occupied						Commercial Owner Occupied		
	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017
	\$ 279,239	\$ 394,139	\$ 110,776	\$ 738,293	\$ 809,241	\$ 205,623	\$ 479,399	\$ 513,861	\$ 217,000
	1,449	4,602	1,290	14,164	7,913	3,856	5,871	7,740	4,130
	594	4,616	789	8	12	81	984	217	44
	—	—	—	—	—	—	—	—	—
	\$ 281,282	\$ 403,357	\$ 112,855	\$ 752,465	\$ 817,166	\$ 209,560	\$ 486,254	\$ 521,818	\$ 221,000

Table of Contents

Commercial & Industrial			Other Income Producing Property			Commercial Total		
June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017
\$ 291,755	\$ 388,342	\$ 112,046	\$ 165,188	\$ 191,229	\$ 81,161	\$ 1,953,874	\$ 2,296,812	\$ 72,000
5,248	9,883	4,642	3,381	4,547	1,542	30,113	34,685	15,000
7,861	471	1,196	823	893	700	10,270	6,209	2,800
—	—	—	—	—	—	—	—	—
\$ 304,864	\$ 398,696	\$ 117,884	\$ 169,392	\$ 196,669	\$ 83,403	\$ 1,994,257	\$ 2,337,706	\$ 74,000

The following table presents the credit risk profile by risk grade of consumer loans for acquired non-credit impaired loans:

Consumer Owner Occupied			Home Equity			Consumer		
June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017
\$ 664,594	\$ 703,557	\$ 514,294	\$ 263,994	\$ 301,842	\$ 167,786	\$ 123,807	\$ 134,530	\$ 123,807
7,495	4,165	2,697	8,319	10,477	4,906	723	541	723
4,507	2,889	3,115	6,593	8,272	4,437	2,135	2,639	2,135
—	—	—	—	—	—	—	—	—
\$ 676,596	\$ 710,611	\$ 520,106	\$ 278,906	\$ 320,591	\$ 177,129	\$ 126,665	\$ 137,710	\$ 126,665

	Other		March 31, 2017	Consumer Total		June 30, 2017
	June 30, 2018	December 31, 2017		June 30, 2018	December 31, 2017	
Pass	\$ —	\$ 1,289	\$ —	\$ 1,052,395	\$ 1,141,218	\$ 822,506
Special mention	—	—	—	16,537	15,183	8,775
Substandard	—	—	—	13,235	13,800	9,432
Doubtful	—	—	—	—	—	—
	\$ —	\$ 1,289	\$ —	\$ 1,082,167	\$ 1,170,201	\$ 840,713

The following table presents the credit risk profile by risk grade of total acquired non-credit impaired loans:

Total Acquired
Non-credit Impaired Loans

Edgar Filing: SOUTH STATE Corp - Form 10-Q

(Dollars in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
Pass	\$ 3,006,269	\$ 3,438,030	\$ 1,549,504
Special mention	46,650	49,868	24,235
Substandard	23,505	20,009	12,242
Doubtful	—	—	—
	\$ 3,076,424	\$ 3,507,907	\$ 1,585,981

The following table presents the credit risk profile by risk grade of acquired credit impaired loans (identified as credit-impaired at the time of acquisition), net of the related discount (this table should be read in conjunction with the allowance for acquired credit impaired loan losses table found on page 28):

(Dollars in thousands)	Commercial Real Estate			Commercial Real Estate— Construction and Development					
	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017			
Pass	\$ 177,996	\$ 177,231	\$ 166,961	\$ 25,243	\$ 29,620	\$ 31,656			
Special mention	22,568	28,708	23,162	4,884	5,132	7,851			
Substandard	27,175	28,656	24,672	10,824	14,897	13,470			
Doubtful	—	—	—	—	—	—			
	\$ 227,739	\$ 234,595	\$ 214,795	\$ 40,951	\$ 49,649	\$ 52,977			

	Residential Real Estate			Consumer		Commercial & Industrial			
	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017	June 30, 2018	December 31, 2017	June 30, 2017
Pass	\$ 116,461	\$ 135,974	\$ 137,735	\$ 6,144	\$ 8,001	\$ 9,178	\$ 6,161	\$ 18,522	\$ 16,534
Special mention	46,089	54,500	52,250	15,613	17,214	18,536	1,139	1,169	4,188
Substandard	66,952	70,313	66,617	23,876	26,238	28,648	5,280	7,255	4,764
Doubtful	—	—	—	—	—	—	—	—	—
	\$ 229,502	\$ 260,787	\$ 256,602	\$ 45,633	\$ 51,453	\$ 56,362	\$ 12,580	\$ 26,946	\$ 25,486

Table of Contents

	Total Acquired Credit Impaired Loans		
	June 30, 2018	December 31, 2017	June 30, 2017
Pass	\$ 332,005	\$ 369,348	\$ 362,064
Special mention	90,293	106,723	105,987
Substandard	134,107	147,359	138,171
Doubtful	—	—	—
	\$ 556,405	\$ 623,430	\$ 606,222

The risk grading of acquired credit impaired loans is determined utilizing a loan's contractual balance, while the amount recorded in the financial statements and reflected above is the carrying value.

The following table presents an aging analysis of past due loans, segregated by class for non-acquired loans:

(Dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans
June 30, 2018						
Commercial real estate:						
Construction and land development	\$ 1,222	\$ —	\$ 344	\$ 1,566	\$ 905,324	\$ 906,890
Commercial non-owner occupied	354	19	659	1,032	1,134,203	1,135,235
Commercial owner occupied	1,578	1,599	1,314	4,491	1,367,962	1,372,453
Consumer real estate:						
Consumer owner occupied	479	387	900	1,766	1,732,158	1,733,924
Home equity loans	913	473	1,114	2,500	454,446	456,946
Commercial and industrial	762	94	815	1,671	939,396	941,067
Other income producing property	157	5	259	421	205,086	205,507
Consumer	475	202	557	1,234	415,416	416,650
Other loans	—	—	—	—	28,867	28,867
	\$ 5,940	\$ 2,779	\$ 5,962	\$ 14,681	\$ 7,182,858	\$ 7,197,539
December 31, 2017						
Commercial real estate:						
Construction and land development	\$ 391	\$ 63	\$ 401	\$ 855	\$ 830,020	\$ 830,875
Commercial non-owner occupied	297	398	51	746	1,008,147	1,008,893
	2,227	382	1,721	4,330	1,258,446	1,262,776

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Commercial owner occupied						
Consumer real estate:						
Consumer owner occupied	1,291	140	1,943	3,374	1,526,886	1,530,260
Home equity loans	1,209	372	1,684	3,265	434,377	437,642
Commercial and industrial	477	57	915	1,449	813,738	815,187
Other income producing property	223	255	198	676	193,171	193,847
Consumer	525	196	623	1,344	377,641	378,985
Other loans	—	—	—	—	33,690	33,690
	\$ 6,640	\$ 1,863	\$ 7,536	\$ 16,039	\$ 6,476,116	\$ 6,492,155
June 30, 2017						
Commercial real estate:						
Construction and land development	\$ 102	\$ —	\$ 505	\$ 607	\$ 711,635	\$ 712,242
Commercial non-owner occupied	123	150	255	528	952,383	952,911
Commercial owner occupied	1,041	799	1,562	3,402	1,201,551	1,204,953
Consumer real estate:						
Consumer owner occupied	1,168	1,112	766	3,046	1,379,876	1,382,922
Home equity loans	779	311	1,370	2,460	409,072	411,532
Commercial and industrial	608	156	97	861	761,722	762,583
Other income producing property	480	104	257	841	188,485	189,326
Consumer	359	188	347	894	356,867	357,761
Other loans	—	—	—	—	18,163	18,163
	\$ 4,660	\$ 2,820	\$ 5,159	\$ 12,639	\$ 5,979,754	\$ 5,992,393

Table of Contents

The following table presents an aging analysis of past due loans, segregated by class for acquired non-credit impaired loans:

(Dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans
June 30, 2018						
Commercial real estate:						
Construction and land development	\$ 666	\$ 66	\$ 309	\$ 1,041	\$ 280,241	\$ 281,282
Commercial non-owner occupied	2,936	—	157	3,093	749,372	752,465
Commercial owner occupied	1,121	11	737	1,869	484,385	486,254
Consumer real estate:						
Consumer owner occupied	1,434	207	860	2,501	674,095	676,596
Home equity loans	1,656	326	2,197	4,179	274,727	278,906
Commercial and industrial	115	118	21	254	304,610	304,864
Other income producing property	544	14	145	703	168,689	169,392
Consumer	436	717	296	1,449	125,216	126,665
	\$ 8,908	\$ 1,459	\$ 4,722	\$ 15,089	\$ 3,061,335	\$ 3,076,424
December 31, 2017						
Commercial real estate:						
Construction and land development	\$ 675	\$ 113	\$ 101	\$ 889	\$ 402,468	\$ 403,357
Commercial non-owner occupied	12	321	—	333	816,833	817,166
Commercial owner occupied	642	—	189	831	520,987	521,818
Consumer real estate:						
Consumer owner occupied	673	204	867	1,744	708,867	710,611
Home equity loans	3,639	609	1,704	5,952	314,639	320,591
Commercial and industrial	5,996	1,278	143	7,417	391,279	398,696
Other income producing property	327	—	250	577	196,092	196,669
Consumer	400	114	1,351	1,865	135,845	137,710
Other	—	—	—	—	1,289	1,289
	\$ 12,364	\$ 2,639	\$ 4,605	\$ 19,608	\$ 3,488,299	\$ 3,507,907
June 30, 2017						
Commercial real estate:						
Construction and land development	\$ 3,784	\$ 2	\$ 192	\$ 3,978	\$ 108,877	\$ 112,855

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Commercial non-owner occupied	519	—	—	519	209,041	209,560
Commercial owner occupied	1,844	143	236	2,223	219,343	221,566
Consumer real estate: Consumer owner occupied	499	801	1,282	2,582	517,524	520,106
Home equity loans	1,109	321	722	2,152	174,977	177,129
Commercial and industrial	710	1,508	98	2,316	115,568	117,884
Other income producing property	336	138	56	530	82,873	83,403
Consumer	540	67	570	1,177	142,301	143,478
	\$ 9,341	\$ 2,980	\$ 3,156	\$ 15,477	\$ 1,570,504	\$ 1,585,981

Table of Contents

The following table presents an aging analysis of past due loans, segregated by class for acquired credit impaired loans:

(Dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans
June 30, 2018						
Commercial real estate	\$ 621	\$ 553	\$ 7,637	\$ 8,811	\$ 218,928	\$ 227,739
Commercial real estate—construction and development	175	—	3,212	3,387	37,564	40,951
Residential real estate	5,279	3,989	6,948	16,216	213,286	229,502
Consumer	767	174	763	1,704	43,929	45,633
Commercial and industrial	125	386	465	976	11,604	12,580
	\$ 6,967	\$ 5,102	\$ 19,025	\$ 31,094	\$ 525,311	\$ 556,405
December 31, 2017						
Commercial real estate	\$ 2,519	\$ 3,669	\$ 2,825	\$ 9,013	\$ 225,582	\$ 234,595
Commercial real estate—construction and development	811	427	3,761	4,999	44,650	49,649
Residential real estate	5,895	4,283	8,824	19,002	241,785	260,787
Consumer	989	452	889	2,330	49,123	51,453
Commercial and industrial	596	167	406	1,169	25,777	26,946
	\$ 10,810	\$ 8,998	\$ 16,705	\$ 36,513	\$ 586,917	\$ 623,430
June 30, 2017						
Commercial real estate	\$ 961	\$ 91	\$ 2,717	\$ 3,769	\$ 211,026	\$ 214,795
Commercial real estate—construction and development	262	252	4,255	4,769	48,208	52,977
Residential real estate	4,581	1,593	8,138	14,312	242,290	256,602
Consumer	518	178	1,203	1,899	54,463	56,362
Commercial and industrial	426	—	2,693	3,119	22,367	25,486
	\$ 6,748	\$ 2,114	\$ 19,006	\$ 27,868	\$ 578,354	\$ 606,222

Table of Contents

The following is a summary of certain information pertaining to impaired non-acquired loans:

(Dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Gross Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
June 30, 2018					
Commercial real estate:					
Construction and land development	\$ 42,955	\$ 600	\$ 41,792	\$ 42,392	\$ 846
Commercial non-owner occupied	1,505	831	517	1,348	93
Commercial owner occupied	5,733	3,031	1,719	4,750	44
Consumer real estate:					
Consumer owner occupied	6,085	4,631	997	5,628	30
Home equity loans	3,256	1,146	1,998	3,144	180
Commercial and industrial	1,876	724	1,110	1,834	485
Other income producing property	3,473	234	3,006	3,240	144
Consumer	325	—	257	257	7
Total	\$ 65,208	\$ 11,197	\$ 51,396	\$ 62,593	\$ 1,829
December 31, 2017					
Commercial real estate:					
Construction and land development	\$ 47,553	\$ 649	\$ 42,581	\$ 43,230	\$ 1,063
Commercial non-owner occupied	3,106	860	515	1,375	125
Commercial owner occupied	9,212	3,553	2,089	5,642	64
Consumer real estate:					
Consumer owner occupied	7,382	4,392	1,240	5,632	37
Home equity loans	3,602	896	2,115	3,011	135
Commercial and industrial	2,246	635	521	1,156	15
Other income producing property	3,893	—	3,138	3,138	178
Consumer	654	—	239	239	7
Total	\$ 77,648	\$ 10,985	\$ 52,438	\$ 63,423	\$ 1,624
June 30, 2017					
Commercial real estate:					
Construction and land development	\$ 34,757	\$ 1,289	\$ 28,748	\$ 30,037	\$ 1,310
Commercial non-owner occupied	2,376	212	542	754	146
Commercial owner occupied	9,882	4,075	1,979	6,054	62
Consumer real estate:					
Consumer owner occupied	6,093	1,451	3,124	4,575	57
Home equity loans	3,311	688	1,938	2,626	119
Commercial and industrial	2,244	—	1,198	1,198	362
Other income producing property	4,382	95	3,546	3,641	238
Consumer	556	—	235	235	6
Total	\$ 63,601	\$ 7,810	\$ 41,310	\$ 49,120	\$ 2,300

Acquired credit impaired loans are accounted for in pools as shown on page 22 rather than being individually evaluated for impairment; therefore, the table above excludes acquired credit impaired loans.

Table of Contents

The following summarizes the average investment in impaired non-acquired loans, and interest income recognized on these loans:

(Dollars in thousands)	Three Months Ended June 30, 2018		2017	
	Average Investment in Impaired Loans	Interest Income Recognized	Average Investment in Impaired Loans	Interest Income Recognized
Commercial real estate:				
Construction and land development	\$ 44,295	\$ 298	\$ 19,662	\$ 267
Commercial non-owner occupied	1,265	9	764	6
Commercial owner occupied	5,164	72	6,153	69
Consumer real estate:				
Consumer owner occupied	5,561	44	4,644	35
Home equity loans	3,156	36	2,529	26
Commercial and industrial	1,756	19	1,234	4
Other income producing property	3,163	42	3,024	68
Consumer	285	—	211	3
Total Impaired Loans	\$ 64,645	\$ 520	\$ 38,221	\$ 478

(Dollars in thousands)	Six Months Ended June 30, 2018		2017	
	Average Investment in Impaired Loans	Interest Income Recognized	Average Investment in Impaired Loans	Interest Income Recognized
Commercial real estate:				
Construction and land development	\$ 42,811	\$ 810	\$ 16,535	\$ 314
Commercial non-owner occupied	1,362	15	780	12
Commercial owner occupied	5,196	147	6,150	145
Consumer real estate:				
Consumer owner occupied	5,630	87	5,124	74
Home equity loans	3,077	65	2,150	46
Commercial and industrial	1,495	36	1,230	22
Other income producing property	3,189	88	3,007	103
Consumer	248	—	189	3
Other loans	—	—	—	—
Total Impaired Loans	\$ 63,008	\$ 1,248	\$ 35,165	\$ 719

The following is a summary of information pertaining to non-acquired nonaccrual loans by class, including restructured loans:

Edgar Filing: SOUTH STATE Corp - Form 10-Q

(Dollars in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
Commercial non-owner occupied real estate:			
Construction and land development	\$ 423	\$ 251	\$ 62
Commercial non-owner occupied	1,109	2,635	2,575
Total commercial non-owner occupied real estate	1,532	2,886	2,637
Consumer real estate:			
Consumer owner occupied	6,465	4,888	4,156
Home equity loans	2,308	269	10
Total consumer real estate	8,773	5,157	4,166
Commercial owner occupied real estate	1,526	1,144	2,641
Commercial and industrial	811	1,662	596
Other income producing property	323	764	1,162
Consumer	893	1,802	898
Restructured loans	902	925	967
Total loans on nonaccrual status	\$ 14,760	\$ 14,340	\$ 13,067

Table of Contents

The following is a summary of information pertaining to acquired non-credit impaired nonaccrual loans by class, including restructured loans:

(Dollars in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
Commercial non-owner occupied real estate:			
Construction and land development	\$ 369	\$ 108	\$ 226
Commercial non-owner occupied	—	—	—
Total commercial non-owner occupied real estate	369	108	226
Consumer real estate:			
Consumer owner occupied	2,136	2,156	1,927
Home equity loans	4,234	4,589	1,515
Total consumer real estate	6,370	6,745	3,442
Commercial owner occupied real estate	885	189	44
Commercial and industrial	101	133	57
Other income producing property	254	316	159
Consumer	1,394	1,906	1,206
Total loans on nonaccrual status	\$ 9,373	\$ 9,397	\$ 5,134

In the course of resolving delinquent loans, the Bank may choose to restructure the contractual terms of certain loans. Any loans that are modified are reviewed by the Bank to determine if a troubled debt restructuring (“TDR” or “restructured loan”) has occurred. The Bank designates loan modifications as TDRs when it grants a concession to a borrower that it would not otherwise consider due to the borrower experiencing financial difficulty (FASB ASC Topic 310-40). The concessions granted on TDRs generally include terms to reduce the interest rate, extend the term of the debt obligation, or modify the payment structure on the debt obligation.

Loans on nonaccrual status at the date of modification are initially classified as nonaccrual TDRs. Loans on accruing status at the date of concession are initially classified as accruing TDRs if the note is reasonably assured of repayment and performance is expected in accordance with its modified terms. Such loans may be designated as nonaccrual loans subsequent to the concession date if reasonable doubt exists as to the collection of interest or principal under the restructuring agreement. Nonaccrual TDRs are returned to accruing status when there is economic substance to the restructuring, there is documented credit evaluation of the borrower’s financial condition, the remaining balance is reasonably assured of repayment in accordance with its modified terms, and the borrower has demonstrated sustained repayment performance in accordance with the modified terms for a reasonable period of time (generally a minimum of six months). For the six months ended June 30, 2018 and 2017, the Company’s TDRs were not material.

The following is a summary of information pertaining to OREO:

(Dollars in thousands)	Six Months Ended June 30,	
	2018 OREO	2017 OREO
Beginning balance	\$ 11,203	\$ 18,316
Acquired in SBFC acquisition	—	385
Acquired in PSC acquisition	210	—
Additions	10,259	4,947
Writedowns	(932)	(1,729)
Sold	(3,518)	(7,489)
Ending Balance	\$ 17,222	\$ 14,430

At June 30, 2018, there were a total of 86 properties included in OREO compared to 75 properties at June 30, 2017. At June 30, 2018, the Company had \$2.8 million in residential real estate included in OREO and \$4.6 million in residential real estate consumer mortgage loans in the process of foreclosure.

Table of Contents

Note 8 — Deposits

The Company's total deposits are comprised of the following:

(Dollars in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
Certificates of deposit	\$ 1,804,657	\$ 1,738,384	\$ 1,026,753
Interest-bearing demand deposits	5,216,942	5,300,108	3,984,163
Non-interest bearing demand deposits	3,152,828	3,047,432	2,635,147
Savings deposits	1,458,208	1,443,918	1,380,231
Other time deposits	5,654	2,924	5,360
Total deposits	\$ 11,638,289	\$ 11,532,766	\$ 9,031,654

At June 30, 2018, December 31, 2017, and June 30, 2017, the Company had \$336.9 million, \$325.3 million, and \$183.1 million in certificates of deposits of \$250,000 and greater, respectively. At June 30, 2018, December 31, 2017, and June 30, 2017, the Company had \$19.8 million, \$43.6 million and \$42.5 million, in traditional, out-of-market brokered deposits, respectively. The increase in certificates of deposits of \$250,000 and greater from June 30, 2017 was primarily the result of deposits acquired through the merger with PSC.

Note 9 — Retirement Plans

The Company and the Bank provide certain retirement benefits to their employees in the form of a non-contributory defined benefit pension plan and an employees' savings plan. The non-contributory defined benefit pension plan covers all employees hired on or before December 31, 2005, who have attained age 21, and who have completed a year of eligible service. Employees hired on or after January 1, 2006 are not eligible to participate in the non-contributory defined benefit pension plan, but are eligible to participate in the employees' savings plan. On this date, a new benefit formula applies only to participants who have not attained age 45 or who do not have five years of service.

Effective July 1, 2009, the Company suspended the accrual of benefits for pension plan participants under the non-contributory defined benefit plan. The pension plan remained suspended as of June 30, 2018.

The components of net periodic pension expense (benefit) recognized are as follows:

(Dollars in thousands)	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Interest cost	\$ 270	\$ 281	\$ 540	\$ 562
Service cost	19	31	39	63
Expected return on plan assets	(582)	(553)	(1,164)	(1,107)
Recognized net actuarial loss	194	188	387	376
Net periodic pension benefit	\$ (99)	\$ (53)	\$ (198)	\$ (106)

Based on the immaterial nature of the components of the net periodic pension expense (benefit), the Company has recorded the entire amount in the line item salaries and employee benefits on the statement of income.

The Company did not contribute to the pension plan for the three and six months ended June 30, 2018, and does not expect to make any additional contributions during the remainder of 2018. The Company reserves the right to contribute between the minimum required and maximum deductible amounts as determined under applicable federal laws.

Under the provisions of Internal Revenue Code Section 401(k), electing employees are eligible to participate in the employees' savings plan after attaining age 21. Plan participants elect to contribute portions of their annual base compensation as a before tax contribution. Employer contributions may be made from current or accumulated net profits. Participants may elect to contribute 1% to 50% of annual base compensation as a before tax contribution. In 2018, employees participating in the plan received a 100% match of their 401(k) plan contribution from the Company, up to 5% of their salary. The employees were also eligible for an additional 1% discretionary matching contribution contingent upon achievement of the Company's annual financial goals which would be paid in the first quarter of the following year. The Company met its financials goals in 2017 and paid the 1% discretionary matching contribution in

Table of Contents

the first quarter of 2018. Also in 2018, the Company changed the 100% match of employees' 401(k) plan contributions to be capped at up to 4% of the participant's salary and raised the discretionary matching contribution to 2% upon achievement of the Company's 2018 financial goals. The Company expensed \$896,000 and \$3.3 million for the 401(k) plan during the three and six months ended June 30, 2018, respectively, compared to \$1.8 million and \$3.4 million, respectively, for the three and six months ended June 30, 2017.

Employees can enter the savings plan on or after the first day of each month. The employee may enter into a salary deferral agreement at any time to select an alternative deferral amount or to elect not to defer in the plan. If the employee does not elect an investment allocation, the plan administrator will select a retirement-based portfolio according to the employee's number of years until normal retirement age. The plan's investment valuations are generally provided on a daily basis.

Note 10 — Earnings Per Share

Basic earnings per share are calculated by dividing net income by the weighted-average shares of common stock outstanding during each period, excluding non-vested shares. The Company's diluted earnings per share are based on the weighted-average shares of common stock outstanding during each period plus the maximum dilutive effect of common stock issuable upon exercise of stock options or vesting of restricted shares. The weighted-average number of shares and equivalents are determined after giving retroactive effect to stock dividends and stock splits.

The following table sets forth the computation of basic and diluted earnings per share:

(Dollars and shares in thousands, except for per share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Basic earnings per common share:				
Net income	\$ 40,459	\$ 31,823	\$ 82,785	\$ 50,087
Weighted-average basic common shares	36,677	29,095	36,657	28,985
Basic earnings per common share	\$ 1.10	\$ 1.09	\$ 2.25	\$ 1.73
Diluted earnings per share:				
Net income	\$ 40,459	\$ 31,823	\$ 82,785	\$ 50,087
Weighted-average basic common shares	36,677	29,095	36,657	28,985
Effect of dilutive securities	252	270	253	267
Weighted-average dilutive shares	36,929	29,365	36,910	29,252
Diluted earnings per common share	\$ 1.09	\$ 1.08	\$ 2.24	\$ 1.71

The calculation of diluted earnings per common share excludes outstanding stock options for which the results would have been anti-dilutive under the treasury stock method as follows:

(Dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Number of shares	61,272	34,712	61,272	34,712
Range of exercise prices	\$ 91.05 to \$ 91.35	\$ 69.48 to \$ 91.35	\$ 91.05 to \$ 91.35	\$ 69.48 to \$ 91.35

Note 11 — Share-Based Compensation

The Company's 2004 and 2012 share-based compensation plans are long-term retention plans intended to attract, retain, and provide incentives for key employees and non-employee directors in the form of incentive and non-qualified stock options, restricted stock, and restricted stock units ("RSUs").

Stock Options

With the exception of non-qualified stock options granted to directors under the 2004 and 2012 plans, which in some cases may be exercised at any time prior to expiration and in some other cases may be exercised at intervals less than a year following the grant date, incentive stock options granted under the plans may not be exercised in whole or in part within a year following the date of the grant, as these incentive stock options become exercisable in 25% increments pro ratably over the four-year period following the grant date. The options are granted at an exercise price at least equal

Table of Contents

to the fair value of the common stock at the date of grant and expire ten years from the date of grant. No options were granted under the 2004 plan after January 26, 2012, and the 2004 plan is closed other than for any options still unexercised and outstanding. The 2012 plan is the only plan from which new share-based compensation grants may be issued. It is the Company's policy to grant options out of the 1,684,000 shares registered under the 2012 plan, of which no more than 817,476 shares can be granted as restricted stock or RSUs.

Activity in the Company's stock option plans is summarized in the following table. All information has been retroactively adjusted for stock dividends and stock splits.

	Shares	Weighted Average Price	Weighted Average Remaining (Yrs.)	Aggregate Intrinsic (000's)
Outstanding at January 1, 2018	218,689	\$ 52.75		
Granted	34,407	91.05		
Exercised	(33,424)	30.88		
Forfeited	(5,806)	91.35		
Outstanding at June 30, 2018	213,866	61.28	6.14	\$ 5,643
Exercisable at June 30, 2018	140,115	49.41	4.80	\$ 5,198
Weighted-average fair value of options granted during the year	\$ 28.01			

The fair value of options is estimated at the date of grant using the Black-Scholes option pricing model and expensed over the options' vesting periods. The following weighted-average assumptions were used in valuing options issued:

	Six months ended June 30,	
	2018	2017
Dividend yield	1.46 %	1.40 %
Expected life	8.5 years	8.5 years
Expected volatility	28.0 %	37.2 %
Risk-free interest rate	2.54 %	2.43 %

As of June 30, 2018, there was \$1.8 million of total unrecognized compensation cost related to nonvested stock option grants under the plans. The cost is expected to be recognized over a weighted-average period of 1.62 years as of June 30, 2018. The total fair value of shares vested during the six months ended June 30, 2018 was \$700,000.

Restricted Stock

The Company from time-to-time also grants shares of restricted stock to key employees and non-employee directors. These awards help align the interests of these employees and directors with the interests of the shareholders of the Company by providing economic value directly related to increases in the value of the Company's stock. The value of the stock awarded is established as the fair market value of the stock at the time of the grant. The Company recognizes expenses, equal to the total value of such awards, ratably over the vesting period of the stock grants. Restricted stock grants to employees typically "cliff vest" after four years. Grants to non-employee directors typically vest within a 12-month period.

All restricted stock agreements are conditioned upon continued employment and service in the case of directors. Termination of employment prior to a vesting date, as described below, would terminate any interest in non-vested shares. Prior to vesting of the shares, as long as employed by the Company, the key employees and non-employee directors will have the right to vote such shares and to receive dividends paid with respect to such shares. All restricted shares will fully vest in the event of change in control of the Company or upon the death of the recipient.

Table of Contents

Nonvested restricted stock for the six months ended June 30, 2018 is summarized in the following table. All information has been retroactively adjusted for stock dividends and stock splits.

Restricted Stock	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2018	142,692	\$ 59.66
Granted	7,836	87.37
Vested	(18,688)	66.61
Nonvested at June 30, 2018	131,840	60.32

As of June 30, 2018, there was \$3.8 million of total unrecognized compensation cost related to nonvested restricted stock granted under the plans. This cost is expected to be recognized over a weighted-average period of 1.79 years as of June 30, 2018. The total fair value of shares vested during the six months ended June 30, 2018 was \$1.4 million.

Restricted Stock Units

The Company from time-to-time also grants performance and discretionary RSUs to key employees. These awards help align the interests of these employees with the interests of the shareholders of the Company by providing economic value directly related to the performance of the Company. Some performance RSU grants contain a three-year performance period while others contain a one-year performance period and a time vested requirement (generally four years from the grant date). The Company communicates threshold, target, and maximum performance RSU awards and performance targets to the applicable key employees at the beginning of a performance period. Discretionary RSUs are based upon prior performance and typically cliff-vest over four years from the grant date. Dividends are not paid in respect to the awards during the performance or the vesting period. The value of the RSUs awarded is established as the fair market value of the stock at the time of the grant. The Company recognizes expenses on a straight-line basis typically over the performance and vesting periods based upon the probable performance target that will be met. For the six months ended June 30, 2018, the Company accrued for 83% of the RSUs granted, based on Management's expectations of performance.

Nonvested RSUs for the six months ended June 30, 2018 is summarized in the following table.

Weighted-Average Grant-Date

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Restricted Stock Units	Shares	Fair Value
Nonvested at January 1, 2018	140,036	\$ 78.49
Granted	100,186	86.34
Vested	(1,176)	84.35
Forfeited	(217)	92.05
LTIP Adjustment	(3,213)	89.40
Nonvested at June 30, 2018	235,616	81.64

As of June 30, 2018, there was \$10.6 million of total unrecognized compensation cost related to nonvested RSUs granted under the plan. This cost is expected to be recognized over a weighted-average period of 2.07 years as of June 30, 2018. The total fair value of RSUs vested during the six months ended June 30, 2018 was \$2.7 million. During the six months ended June 30, 2018, 38,365 vested restricted stock units were issued to the participants in the 2015 Long-Term Incentive Plan and 15,836 nonvested restricted stock units were issued to participants in the 2017 Management Incentive Plan.

Note 12 — Commitments and Contingent Liabilities

In the normal course of business, the Company makes various commitments and incurs certain contingent liabilities, which are not reflected in the accompanying financial statements. The commitments and contingent liabilities include guarantees, commitments to extend credit, and standby letters of credit. At June 30, 2018, commitments to

Table of Contents

extend credit and standby letters of credit totaled \$2.9 billion. The Company does not anticipate any material losses as a result of these transactions.

The Company has been named as defendant in various legal actions, arising from its normal business activities, in which damages in various amounts are claimed. The Company is also exposed to litigation risk related to the prior business activities of banks acquired through whole bank acquisitions as well as banks from which assets were acquired and liabilities assumed in FDIC-assisted transactions. Although the amount of any ultimate liability with respect to such matters cannot be determined, in the opinion of management, any such liability is not expected to have a material effect on the Company's consolidated financial statements.

Note 13 — Fair Value

FASB ASC Topic 820, Fair Value Measurements and Disclosures, defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements. FASB ASC Topic 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Available for sale securities, derivative contracts, and mortgage servicing rights ("MSRs") are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans, OREO, and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

FASB ASC Topic 820 establishes a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows:

- Level 1 Observable inputs such as quoted prices in active markets;
- Level 2 Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3 Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

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

Investment Securities

Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange and The NASDAQ Stock Market, or U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities and debentures issued by government sponsored entities, municipal bonds and corporate debt securities. Securities held to maturity are valued at quoted market prices or dealer quotes similar to securities available for sale. The carrying value of FHLB stock approximates fair value based on the redemption provisions.

Mortgage Loans Held for Sale

Mortgage loans held for sale are carried at fair value. The fair values of mortgage loans held for sale are based on commitments on hand from investors within the secondary market for loans with similar characteristics. As such, the fair value adjustments for mortgage loans held for sale are recurring Level 2.

Loans

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

Table of Contents

principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment using estimated fair value methodologies. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At June 30, 2018, substantially all of the impaired loans were evaluated based on the fair value of the collateral because such loans were considered collateral dependent. Impaired loans, where an allowance is established based on the fair value of collateral; require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company considers the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the impaired loan as nonrecurring Level 3.

Other Real Estate Owned

Typically OREO, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs (Level 2). However, OREO is considered Level 3 in the fair value hierarchy because management has qualitatively applied a discount due to the size, supply of inventory, and the incremental discounts applied to the appraisals. Management also considers other factors, including changes in absorption rates, length of time the property has been on the market and anticipated sales values, which have resulted in adjustments to the collateral value estimates indicated in certain appraisals. At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the ALLL. Gains or losses on sale and generally any subsequent adjustments to the value are recorded as a component of OREO expense.

Derivative Financial Instruments

Fair value is estimated using pricing models of derivatives with similar characteristics; accordingly, the derivatives are classified within Level 2 of the fair value hierarchy (see Note 15—Derivative Financial Instruments for additional information).

Mortgage servicing rights

The estimated fair value of MSR is obtained through an independent derivatives dealer analysis of future cash flows. The evaluation utilizes assumptions market participants would use in determining fair value including market discount rates, prepayment speeds, servicing income, servicing costs, default rates and other market driven data, as well as the

market's perception of future interest rate movements. MSRs are classified as Level 3.

Table of Contents

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

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

(Dollars in thousands)	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2018:				
Assets				
Derivative financial instruments	\$ 8,848	\$ —	\$ 8,848	\$ —
Loans held for sale	36,968	—	36,968	—
Securities available for sale:				
Government-sponsored entities debt	47,613	—	47,613	—
State and municipal obligations	223,816	—	223,816	—
Mortgage-backed securities	1,306,570	—	1,306,570	—
Corporate securities	—	—	—	—
Total securities available for sale	1,577,999	—	1,577,999	—
Mortgage servicing rights	35,107	—	—	35,107
	\$ 1,658,922	\$ —	\$ 1,623,815	\$ 35,107
Liabilities				
Derivative financial instruments	\$ 8,097	\$ —	\$ 8,097	\$ —
December 31, 2017:				
Assets				
Derivative financial instruments	\$ 3,306	\$ —	\$ 3,306	\$ —
Loans held for sale	70,890	—	70,890	—
Securities available for sale:				
Government-sponsored entities debt	85,509	—	85,509	—
State and municipal obligations	220,437	—	220,437	—
Mortgage-backed securities	1,340,687	—	1,340,687	—
Corporate securities	1,560	—	1,560	—
Total securities available for sale	1,648,193	—	1,648,193	—
Mortgage servicing rights	31,119	—	—	31,119
	\$ 1,753,508	\$ —	\$ 1,722,389	\$ 31,119
Liabilities				
Derivative financial instruments	\$ 3,248	\$ —	\$ 3,248	\$ —
June 30, 2017:				
Assets				
Derivative financial instruments	\$ 1,956	\$ —	\$ 1,956	\$ —
Loans held for sale	65,995	—	65,995	—

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Securities available for sale:				
Government-sponsored entities debt	75,952	—	75,952	—
State and municipal obligations	193,294	—	193,294	—
Mortgage-backed securities	1,068,597	—	1,068,597	—
Corporate securities	2,584	2,584	—	—
Total securities available for sale	1,340,427	2,584	1,337,843	—
Mortgage servicing rights	29,930	—	—	29,930
	\$ 1,438,308	\$ 2,584	\$ 1,405,794	\$ 29,930
Liabilities				
Derivative financial instruments	\$ 592	\$ —	\$ 592	\$ —

Table of Contents

Changes in Level 1, 2 and 3 Fair Value Measurements

When a determination is made to classify a financial instrument within Level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, since Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources), the gains and losses below include changes in fair value due in part to observable factors that are part of the valuation methodology.

There were no changes in hierarchy classifications of Level 3 assets or liabilities for the six months ended June 30, 2018. A reconciliation of the beginning and ending balances of Level 3 assets and liabilities recorded at fair value on a recurring basis for the six months ended June 30, 2018 and 2017 is as follows:

(Dollars in thousands)	Assets	Liabilities
Fair value, January 1, 2018	\$ 31,119	\$ —
Servicing assets that resulted from transfers of financial assets	3,112	—
Changes in fair value due to valuation inputs or assumptions	2,945	—
Changes in fair value due to decay	(2,069)	—
Fair value, June 30, 2018	\$ 35,107	\$ —
Fair value, January 1, 2017	\$ 29,037	\$ —
Servicing assets that resulted from transfers of financial assets	3,096	—
Changes in fair value due to valuation inputs or assumptions	(371)	—
Changes in fair value due to decay	(1,832)	—
Fair value, June 30, 2017	\$ 29,930	\$ —

There were no unrealized losses included in accumulated other comprehensive income related to Level 3 financial assets and liabilities at June 30, 2018 or 2017.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

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

Quoted Prices In Active Markets	Significant Other	Significant
---------------------------------------	----------------------	-------------

Edgar Filing: SOUTH STATE Corp - Form 10-Q

(Dollars in thousands)	Fair Value	for Identical Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
June 30, 2018:				
OREO	\$ 17,222	\$ —	\$ —	\$ 17,222
Non-acquired impaired loans	5,909	—	—	5,909
December 31, 2017:				
OREO	\$ 11,203	\$ —	\$ —	\$ 11,203
Non-acquired impaired loans	10,495	—	—	10,495
June 30, 2017:				
OREO	\$ 14,430	\$ —	\$ —	\$ 14,430
Non-acquired impaired loans	3,754	—	—	3,754

Table of Contents

Quantitative Information about Level 3 Fair Value Measurement

	Valuation Technique	Unobservable Input	Weighted Average						
			June 30, 2018		December 31, 2017		June 30, 2017		
Nonrecurring measurements:									
Non-acquired impaired loans	Discounted appraisals	Collateral discounts	3	%	3		%	5	%
OREO	Discounted appraisals	Collateral discounts and estimated costs to sell	17	%	21		%	25	%

Fair Value of Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those models are significantly affected by the assumptions used, including the discount rates and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. The use of different methodologies may have a material effect on the estimated fair value amounts. The fair value estimates presented herein are based on pertinent information available to management as of June 30, 2018, December 31, 2017 and June 30, 2017. Such amounts have not been revalued for purposes of these consolidated financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents — The carrying amount is a reasonable estimate of fair value.

Investment Securities — Securities held to maturity are valued at quoted market prices or dealer quotes. The carrying value of FHLB stock approximates fair value based on the redemption provisions. The carrying value of the Company's investment in unconsolidated subsidiaries approximates fair value. See Note 5—Investment Securities for additional information, as well as page 41 regarding fair value.

Loans held for sale — The fair values disclosed for loans held for sale are based on commitments from investors for loans with similar characteristics.

Loans — ASU 2016-01 - Financial Instruments – Overall – Recognition and Measurement of Financial Assets and Financial Liabilities became effective for the Company on January 1, 2018. This accounting standard requires the company to calculate the fair value of our loans for disclosure purposes based on an estimated exit price. In previous periods we have calculated fair value using only discounted cash flows on fixed rate loans. Therefore, the fair value for loans for June 30, 2018 will be calculated using a different method than that used at December 31, 2017 and June 30, 2017.

With ASU 2016-01, to estimate an exit price, all loans (fixed and variable) are being valued with a discounted cash flow analyses for loans that includes the Company's estimate of future credit losses expected to be incurred over the life of the loans. Fair values for certain mortgage loans (e.g., one-to-four family residential) and other consumer loans are estimated using discounted cash flow analyses based on the Company's current rates offered for new loans of the same type, structure and credit quality. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial and industrial loans) are estimated using discounted cash flow analyses, using interest rates currently being offered by the Company for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using a discounted cash flow analyses.

For previous periods, variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Also, for all other loans where a discounted cash flow analyses was used, there was no estimate of future credit losses expected to be incurred over the life of the loans included in the valuation.

Table of Contents

Deposit Liabilities — The fair values disclosed for demand deposits (e.g., interest and non-interest bearing checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts, and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Federal Funds Purchased and Securities Sold Under Agreements to Repurchase — The carrying amount of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings maturing within ninety days approximate their fair values.

Other Borrowings — The fair value of other borrowings is estimated using discounted cash flow analysis on the Company's current incremental borrowing rates for similar types of instruments.

Accrued Interest — The carrying amounts of accrued interest approximate fair value.

Derivative Financial Instruments — The fair value of derivative financial instruments (including interest rate swaps) is estimated using pricing models of derivatives with similar characteristics.

Commitments to Extend Credit, Standby Letters of Credit and Financial Guarantees — The fair values of commitments to extend credit are estimated taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair values of guarantees and letters of credit are based on fees currently charged for similar agreements or on the estimated costs to terminate them or otherwise settle the obligations with the counterparties at the reporting date.

Table of Contents

The estimated fair value, and related carrying amount, of the Company's financial instruments are as follows:

(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
June 30, 2018					
Financial assets:					
Cash and cash equivalents	\$ 396,849	\$ 396,849	\$ 396,849	\$ —	\$ —
Investment securities	1,597,727	1,597,731	19,229	1,578,502	—
Loans held for sale	36,968	36,968	—	36,968	—
Loans, net of allowance for loan losses (1)	10,778,068	10,547,778	—	—	10,547,778
Accrued interest receivable	33,751	33,751	—	7,333	26,418
Mortgage servicing rights	35,107	35,107	—	—	35,107
Interest rate swap - non-designated hedge	7,750	7,750	—	7,750	—
Other derivative financial instruments (mortgage banking related)	1,098	1,098	—	1,098	—
Financial liabilities:					
Deposits	11,638,289	10,675,705	—	10,675,705	—
Federal funds purchased and securities sold under agreements to repurchase	331,969	331,969	—	331,969	—
Other borrowings	115,754	119,221	—	119,221	—
Accrued interest payable	3,882	3,882	—	3,882	—
Interest rate swap - non-designated hedge	7,981	7,981	—	7,981	—
Interest rate swap - cash flow hedge	116	116	—	116	—
Off balance sheet financial instruments:					
Commitments to extend credit	—	(62,060)	—	(62,060)	—
December 31, 2017					
Financial assets:					
Cash and cash equivalents	\$ 377,627	\$ 377,627	\$ 377,627	\$ —	\$ —
Investment securities	1,673,769	1,673,796	23,047	1,650,749	—
Loans held for sale	70,890	70,890	—	70,890	—
Loans, net of allowance for loan losses (1)	10,575,417	10,724,264	—	—	10,724,264
Accrued interest receivable	32,727	32,727	—	7,051	25,676
Mortgage servicing rights	31,119	31,119	—	—	31,119
Interest rate swap - non-designated hedge	2,367	2,367	—	2,367	—
Other derivative financial instruments (mortgage	939	939	—	939	—

Edgar Filing: SOUTH STATE Corp - Form 10-Q

banking related)					
Financial liabilities:					
Deposits	11,532,766	10,796,380	—	10,796,380	—
Federal funds purchased and securities sold under agreements to repurchase	286,857	286,857	—	286,857	—
Other borrowings	216,385	219,421	—	219,421	—
Accrued interest payable	2,789	2,789	—	2,789	—
Interest rate swap - non-designated hedge	2,750	2,750	—	2,750	—
Interest rate swap - cash flow hedge	246	246	—	246	—
Other derivative financial instruments (mortgage banking related)	252	252	—	252	—
Off balance sheet financial instruments:					
Commitments to extend credit	—	41,319	—	41,319	—
June 30, 2017					
Financial assets:					
Cash and cash equivalents	\$ 431,890	\$ 431,890	\$ 431,890	\$ —	\$ —
Investment securities	1,358,894	1,358,976	14,301	1,344,675	—
Loans held for sale	65,995	65,995	—	65,995	—
Loans, net of allowance for loan losses (1)	8,140,706	8,216,793	—	—	8,216,793
Accrued interest receivable	23,469	23,469	—	5,454	18,015
Mortgage servicing rights	29,930	29,930	—	—	29,930
Interest rate swap - non-designated hedge	208	208	—	208	—
Other derivative financial instruments (mortgage banking related)	1,748	1,748	—	1,748	—
Financial liabilities:					
Deposits	9,031,654	8,481,700	—	8,481,700	—
Federal funds purchased and securities sold under agreements to repurchase	334,018	334,018	—	334,018	—
Other borrowings	98,147	100,723	—	100,723	—
Accrued interest payable	1,502	1,502	—	1,502	—
Interest rate swap - cash flow hedge	389	389	—	389	—
Interest rate swap - non-designated hedge	203	203	—	203	—
Off balance sheet financial instruments:					
Commitments to extend credit	—	17,200	—	17,200	—
(1) - Loans, net of allowance for loan losses is being valued using a different					

method at June 30, 2018 from December 31, 2017 and June 30, 2017. See page 45 for explanation of change in method.

Table of Contents

Note 14 — Accumulated Other Comprehensive Income (Loss)

The changes in each components of accumulated other comprehensive income (loss), net of tax, were as follows:

(Dollars in thousands)	Benefit Plans	Unrealized Gains and Losses on Securities Available for Sale	Gains and Losses on Cash Flow Hedges	Total
Three Months Ended June 30, 2018				
Balance at March 31, 2018	\$ (7,607)	\$ (22,617)	\$ (126)	\$ (30,350)
Other comprehensive income (loss) before reclassifications	—	(6,409)	6	(6,403)
Amounts reclassified from accumulated other comprehensive income (loss)	151	500	31	682
Net comprehensive income (loss)	151	(5,909)	37	(5,721)
Balance at June 30, 2018	\$ (7,456)	\$ (28,526)	\$ (89)	\$ (36,071)
Three Months Ended June 30, 2017				
Balance at March 31, 2017	\$ (6,078)	\$ 1,458	\$ (264)	\$ (4,884)
Other comprehensive income before reclassifications	—	1,115	11	1,126
Amounts reclassified from accumulated other comprehensive income (loss)	116	(67)	12	61
Net comprehensive income	116	1,048	23	1,187
Balance at June 30, 2017	\$ (5,962)	\$ 2,506	\$ (241)	\$ (3,697)
Six Months Ended June 30, 2018				
Balance at December 31, 2017	\$ (5,998)	\$ (4,278)	\$ (151)	\$ (10,427)
Other comprehensive income (loss) before reclassifications	—	(23,601)	34	(23,567)
Amounts reclassified from accumulated other comprehensive income (loss)	302	500	68	870
Net comprehensive income (loss)	302	(23,101)	102	(22,697)
AOCI reclassification to retained earnings from the adoption of ASU 2018-02	(1,760)	(1,147)	(40)	(2,947)
Balance at June 30, 2018	\$ (7,456)	\$ (28,526)	\$ (89)	\$ (36,071)
Six Months Ended June 30, 2017				
Balance at December 31, 2016	\$ (6,195)	\$ (1,708)	\$ (308)	\$ (8,211)
Other comprehensive income (loss) before reclassifications	—	4,282	(37)	4,245
	233	(68)	104	269

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Amounts reclassified from accumulated other
comprehensive income (loss)

Net comprehensive income	233	4,214	67	4,514
Balance at June 30, 2017	\$ (5,962)	\$ 2,506	\$ (241)	\$ (3,697)

48

Table of Contents

The table below presents the reclassifications out of accumulated other comprehensive income (loss), net of tax:

(Dollars in thousands)	Amount Reclassified from Accumulated Other Comprehensive Income (Loss)				Income Statement Line Item Affected
	For the Three Months Ended June 30,		For the Six Months Ended June 30,		
Accumulated Other Comprehensive Income (Loss) Component	2018	2017	2018	2017	
Losses on cash flow hedges:					
Interest rate contracts	\$ 39	\$ 19	\$ 87	\$ 168	Interest expense
	(8)	(7)	(19)	(64)	Provision for income taxes
	31	12	68	104	Net income
(Gains) losses on sales of available for sale securities:					
	\$ 641	\$ (110)	\$ 641	\$ (110)	Securities (gains) losses, net
	(141)	43	(141)	42	Provision for income taxes
	500	(67)	500	(68)	Net income
Amortization of defined benefit pension:					
Actuarial losses	\$ 194	\$ 187	\$ 387	\$ 376	Salaries and employee benefits
	(43)	(71)	(85)	(143)	Provision for income taxes
	151	116	302	233	Net income
Total reclassifications for the period	\$ 682	\$ 61	\$ 870	\$ 269	

Note 15 — Derivative Financial Instruments

The Company uses certain derivative instruments to meet the needs of its customers as well as to manage the interest rate risk associated with certain transactions. The following table summarizes the derivative financial instruments utilized by the Company:

(Dollars in thousands)	Balance Sheet Location	Notional Amount	June 30, 2018		Notional Amount	June 30, 2017	
			Estimated Fair Value Gain	Loss		Estimated Fair Value Gain	Loss

Edgar Filing: SOUTH STATE Corp - Form 10-Q

Cash flow hedges of interest rate risk:							
Pay fixed rate swap with counterparty	Other Liabilities	\$ 8,000	\$ —	\$ 116	\$ 8,000	\$ —	\$ 389
Fair value hedge of interest rate risk:							
Pay fixed rate swap with counterparty	Other Assets	\$ 2,824	\$ 8	\$ —	\$ —	\$ —	\$ —
Not designated hedges of interest rate risk:							
Customer related interest rate contracts:							
Matched interest rate swaps with borrowers	Other Assets and Other Liabilities	\$ 327,027	\$ 437	\$ 7,947	\$ 13,629	\$ 208	\$ —
Matched interest rate swaps with counterparty	Other Assets and Other Liabilities	\$ 327,027	\$ 7,271	\$ —	\$ 13,629	\$ —	\$ 203
Not designated hedges of interest rate risk: Foreign Exchange							
Customer related interest rate contracts:							
Matched interest rate swaps with borrowers	Other Assets and Other Liabilities	\$ 2,521	\$ —	\$ 34	\$ —	\$ —	\$ —
Matched interest rate swaps with counterparty	Other Assets and Other Liabilities	\$ 2,521	\$ 34	\$ —	\$ —	\$ —	\$ —
Not designated hedges of interest rate risk - mortgage banking activities:							
Contracts used to hedge mortgage servicing rights	Other Assets	\$ 63,500	\$ 291	\$ —	\$ 102,500	\$ 9	\$ —
Forward sales commitments used to hedge mortgage pipeline	Other Assets	\$ 92,584	\$ 807	\$ —	\$ 109,525	1,657	\$ —
Total derivatives		\$ 826,004	\$ 8,848	\$ 8,097	\$ 247,283	\$ 1,874	\$ 592

Cash Flow Hedge of Interest Rate Risk

The Company is exposed to interest rate risk in the course of its business operations and manages a portion of this risk through the use of derivative financial instruments, in the form of interest rate swaps. The Company accounts for its interest rate swap that is classified as a cash flow hedge in accordance with FASB ASC 815, Derivatives and Hedging, which requires that all derivatives be recognized as assets or liabilities on the balance sheet at fair value. For

Table of Contents

more information regarding the fair value of the Company's derivative financial instruments, see Note 13 to these financial statements.

The Company utilizes an interest rate swap agreement to essentially convert a portion of its variable-rate debt to a fixed rate (cash flow hedge). For derivatives designated as hedging exposure to variable cash flows of a forecasted transaction (cash flow hedge), the effective portion of the derivative's gain or loss is initially reported as a component of other comprehensive income and subsequently reclassified into earnings when the forecasted transaction affects earnings or when the hedge is terminated. The ineffective portion of the gain or loss is reported in earnings immediately. For derivatives that are not designated as hedging instruments, changes in the fair value of the derivatives are recognized in earnings immediately.

When applying hedge accounting for derivatives, the Company establishes a method for assessing the effectiveness of the hedging derivative and a measurement approach for determining the ineffective aspect of the hedge upon the inception of the hedge.

During 2009, the Company entered into a forward starting interest rate swap agreement with a notional amount of \$8.0 million to manage interest rate risk due to periodic rate resets on its junior subordinated debt issued by SCBT Capital Trust II, an unconsolidated subsidiary of the Company established for the purpose of issuing trust preferred securities. The Company hedges the variable rate cash flows of subordinated debt against future interest rate increases by using an interest rate swap that effectively fixed the rate on the debt beginning on June 15, 2010, at which time the debt contractually converted from a fixed interest rate to a variable interest rate. This hedge expires on June 15, 2019. The notional amount on which the interest payments are based will not be exchanged. This derivatives contract calls for the Company to pay a fixed rate of 4.06% on \$8.0 million notional amount and receive a variable rate of three-month LIBOR on the \$8.0 million notional amount.

The Company recognized an after-tax unrealized gain on its cash flow hedge in other comprehensive income of \$37,000 and \$102,000 for the three and six months ended June 30, 2018, respectively. This compares to an unrealized gain of \$23,000 and \$67,000 for the three months ended June 30, 2017, respectively. The Company recognized a \$116,000 cash flow hedge liability in other liabilities on the balance sheet at June 30, 2018, compared to a \$389,000 liability at June 30, 2017. There was no ineffectiveness in the cash flow hedge during the three and six months ended June 30, 2018 and 2017.

Credit risk related to the derivative arises when amounts receivable from the counterparty (derivatives dealer) exceed those payable. The Company controls the risk of loss by only transacting with derivatives dealers that are national market makers whose credit ratings are strong. Each party to the interest rate swap is required to provide collateral in the form of cash or securities to the counterparty when the counterparty's exposure to a mark-to-market replacement value exceeds certain negotiated limits. These limits are typically based on current credit ratings and vary with ratings changes. As of June 30, 2018 and 2017, the Company provided \$300,000 and \$450,000 of collateral, respectively, which is included in cash and cash equivalents on the balance sheet as interest-bearing deposits with banks. Also, the Company has a netting agreement with the counterparty.

Balance Sheet Fair Value Hedge

The Company maintains one loan swap, with an aggregate notional amount of \$2.8 million at June 30, 2018, accounted for as fair value hedges in accordance with ASC 815, Derivatives and Hedging. This derivative protects the company from interest rate risk caused by changes in the LIBOR curve in relation to a certain designated fixed rate loan. The derivative converts the fixed rate loan to a floating rate. Settlement occurs in any given period where there is a difference in the stated fixed rate and variable rate. The fair value of this hedge is recorded in other assets and in other liabilities. All changes in fair value are recorded through earnings as noninterest income. There was no gain or loss recorded on this derivative for the three and six months ended June 30, 2018 or 2017.

Non-designated Hedges of Interest Rate Risk

Customer Swap

The Company maintains interest rate swap contracts with customers that are classified as non-designated hedges and are not speculative in nature. These agreements are designed to convert customer's variable rate loans with

Table of Contents

the Company to fixed rate. These interest rate swaps are executed with loan customers to facilitate a respective risk management strategy and allow the customer to pay a fixed rate of interest to the Company. These interest rate swaps are simultaneously hedged by executing offsetting interest rate swaps with unrelated market counterparties to minimize the net risk exposure to the Company resulting from the transactions and allow the Company to receive a variable rate of interest. The interest rate swaps pay and receive interest based on a floating rate based on one month LIBOR plus credit spread, with payments being calculated on the notional amount. The interest rate swaps are settled monthly with varying maturities.

As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of June 30, 2018, the interest rate swaps had an aggregate notional amount of approximately \$654.1 million and the fair value of the interest rate swap derivatives are recorded in other assets at \$7.7 million and in other liabilities at \$7.9 million for a net liability position of \$240,000, which was recorded through earnings. As of June 30, 2017, the interest rate swaps had an aggregate notional amount of approximately \$27.3 million and the fair value of the interest rate swap derivatives are recorded in other assets at \$208,000 and in other liabilities at \$203,000 for a net asset carrying value of \$5,000, which was recorded through earnings. The fair value of the interest rate swap derivative with the derivatives dealer was in a net liability position of \$203,000 at June 30, 2017.

Foreign Exchange

The Company also enters into foreign exchange contracts with customers to accommodate their need to convert certain foreign currencies into to U.S. Dollars. To offset the foreign exchange risk, the Company has entered into substantially identical agreements with an unrelated market counterparty to hedge these foreign exchange contracts. The foreign exchange contracts had a notional amount of \$2.5 million at June 30, 2018, representing the amount of contracts outstanding in U.S. dollars. The fair value of these contracts are included in other assets and other liabilities in the accompanying balance sheet. All changes in fair value are recorded as other noninterest income. There was no gain or loss recorded related to the foreign exchange derivative for the three and six months ended June 30, 2018 or 2017.

Mortgage Banking

The Company also has derivatives contracts that are classified as non-designated hedges. These derivatives contracts are a part of the Company's risk management strategy for its mortgage banking activities. These instruments may include financial forwards, futures contracts, and options written and purchased, which are used to hedge MSR's; while forward sales commitments are typically used to hedge the mortgage pipeline. Such instruments derive their cash flows, and therefore their values, by reference to an underlying instrument, index or referenced interest rate. The Company does not elect hedge accounting treatment for any of these derivative instruments and as a result, changes in fair value of the instruments (both gains and losses) are recorded in the Company's consolidated statements of income in mortgage banking income.

Mortgage Servicing Rights

Derivatives contracts related to MSRs are used to help offset changes in fair value and are written in amounts referred to as notional amounts. Notional amounts provide a basis for calculating payments between counterparties but do not represent amounts to be exchanged between the parties, and are not a measure of financial risk. On June 30, 2018, the Company had derivative financial instruments outstanding with notional amounts totaling \$63.5 million related to MSRs, compared to \$102.5 million on June 30, 2017. The estimated net fair value of the open contracts related to the MSRs was recorded as a gain of \$291,000 at June 30, 2018, compared to a gain of \$9,000 at June 30, 2017.

Table of Contents

Mortgage Pipeline

The following table presents the Company's notional value of forward sale commitments and the fair value of those obligations along with the fair value of the mortgage pipeline.

(Dollars in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
Mortgage loan pipeline	\$ 89,085	\$ 71,477	\$ 115,820
Expected closures	66,813	53,608	86,865
Fair value of mortgage loan pipeline commitments	1,159	920	1,568
Forward sales commitments	92,584	89,317	109,525
Fair value of forward commitments	(352)	19	89

Note 16 — Capital Ratios

The Company is subject to regulations with respect to certain risk-based capital ratios. These risk-based capital ratios measure the relationship of capital to a combination of balance sheet and off-balance sheet risks. The values of both balance sheet and off-balance sheet items are adjusted based on the rules to reflect categorical credit risk. In addition to the risk-based capital ratios, the regulatory agencies have also established a leverage ratio for assessing capital adequacy. The leverage ratio is equal to Tier 1 capital divided by total consolidated on-balance sheet assets (minus amounts deducted from Tier 1 capital). The leverage ratio does not involve assigning risk weights to assets.

In July 2013, the Federal Reserve announced its approval of a final rule to implement the regulatory capital reforms developed by the Basel Committee on Banking Supervision ("Basel III"), among other changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The new rules became effective January 1, 2015, subject to a phase-in period for certain aspects of the new rules.

As applied to the Company and the Bank, the new rules include a new minimum ratio of common equity Tier 1 capital ("CET1") to risk-weighted assets of 4.5%. The new rules also raised the minimum required ratio of Tier 1 capital to risk-weighted assets from 4% to 6%. The minimum required leverage ratio under the new rules is 4%. The minimum required total capital to risk-weighted assets ratio remains at 8% under the new rules.

In order to avoid restrictions on capital distributions and discretionary bonus payments to executives, under the new rules a covered banking organization is also required to maintain a “capital conservation buffer” in addition to its minimum risk-based capital requirements. This buffer is required to consist solely of common equity Tier 1, and the buffer applies to all three risk-based measurements (CET1, Tier 1 capital and total capital). The capital conservation buffer will be phased in incrementally over time, beginning January 1, 2016 and becoming fully effective on January 1, 2019, and will ultimately consist of an additional amount of Tier 1 common equity equal to 2.5% of risk-weighted assets.

The Bank is also subject to the regulatory framework for prompt corrective action, which identifies five capital categories for insured depository institutions (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized) and is based on specified thresholds for each of the three risk-based regulatory capital ratios (CET1, Tier 1 capital and total capital) and for the leverage ratio.

Table of Contents

The following table presents actual and required capital ratios as of June 30, 2018, December 31, 2017 and June 30, 2017 for the Company and the Bank under the Basel III capital rules. The minimum required capital amounts presented include the minimum required capital levels as of June 30, 2018 based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

	Actual		Minimum Capital Required - Basel III Phase-In Schedule		Minimum Capital Required - Basel III Fully Phased In		Required to be Considered Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)								
June 30, 2018								
Common equity Tier 1 to risk-weighted assets:								
Consolidated	\$ 1,324,901	12.00 %	\$ 704,261	6.38 %	\$ 773,306	7.00 %	\$ 718,070	6.50
South State Bank (the Bank)	1,413,812	12.80 %	704,275	6.38 %	773,321	7.00 %	718,084	6.50
Tier 1 capital to risk-weighted assets:								