S Y BANCORP INC
Form 10-Q
November 04, 2010
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**

For the quarterly period ended September 30, 2010

OR

o **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 1-13661

S.Y. BANCORP, INC.

(Exact name of registrant as specified in its charter)

Kentucky	**61-1137529**
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization)	Identification No.)

1040 East Main Street, Louisville, Kentucky 40206

(Address of principal executive offices including zip code)

(502) 582-2571

(Registrant s telephone number, including area code)

Not Applicable

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o 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 x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of the registrant s Common Stock, no par value, outstanding as of October 29, 2010, was 13,711,873.

Table of Contents

S.Y. BANCORP, INC. AND SUBSIDIARY

Index

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

The following consolidated financial statements of S.Y. Bancorp, Inc. and Subsidiary, Stock Yards Bank & Trust Company, are submitted herewith:

Table of Contents

S.Y. BANCORP, INC. AND SUBSIDIARY

Unaudited Condensed Consolidated Balance Sheets

September 30, 2010 and December 31, 2009

(In thousands, except share data)

	(Unaudited) September 30, 2010	December 31, 2009
Assets		
Cash and due from banks	$ 26,301	$ 25,773
Federal funds sold and interest bearing due from banks	5,021	6,651
Mortgage loans held for sale	9,918	13,249
Securities available for sale (amortized cost of $249,683 in 2010 and $224,488 in 2009)	257,806	228,225
Securities held to maturity (fair value of $25 in 2010 and $37 in 2009)	24	35
Federal Home Loan Bank stock and other securities	5,772	5,547
Loans	1,489,398	1,435,462
Less allowance for loan losses	24,433	20,000
Net loans	1,464,965	1,415,462
Premises and equipment, net	30,832	28,016
Bank owned life insurance	25,872	25,130
Accrued interest receivable	5,861	5,745
Other assets	48,750	37,646
Total assets	$ 1,881,122	$ 1,791,479
Liabilities and Stockholders Equity		
Deposits:		
Non-interest bearing	$ 251,481	$ 211,352
Interest bearing	1,211,298	1,206,832
Total deposits	1,462,779	1,418,184
Securities sold under agreements to repurchase	60,911	51,321
Federal funds purchased	23,271	19,518
Other short-term borrowings	1,232	1,809
Accrued interest payable	417	427
Other liabilities	43,558	45,223
Federal Home Loan Bank advances	80,445	60,453
Subordinated debentures	40,900	40,930
Total liabilities	$ 1,713,513	$ 1,637,865
Stockholders equity:		
Preferred stock, no par value. Authorized 1,000,000 shares; no shares issued or outstanding		
Common stock, no par value. Authorized 20,000,000 shares; issued and outstanding 13,707,043 and 13,606,532 shares in 2010 and 2009, respectively	6,579	6,244
Additional paid-in capital	11,734	9,729
Retained earnings	144,247	135,442
Accumulated other comprehensive income	5,049	2,199
Total stockholders equity	167,609	153,614
Total liabilities and stockholders equity	$ 1,881,122	$ 1,791,479

See accompanying notes to unaudited condensed consolidated financial statements.

2

Table of Contents

S.Y. BANCORP, INC. AND SUBSIDIARY

Unaudited Condensed Consolidated Statements of Income

For the three and nine months ended September 30, 2010 and 2009

(In thousands, except per share data)

	For three months ended September 30, 2010	For three months ended September 30, 2009	For nine months ended September 30, 2010	For nine months ended September 30, 2009
Interest income:				
Loans	$ 20,285	$ 19,418	$ 59,214	$ 57,365
Federal funds sold	41	31	85	51
Mortgage loans held for sale	97	105	216	286
Securities taxable	1,271	1,392	4,051	4,000
Securities tax-exempt	324	279	857	837
Total interest income	22,018	21,225	64,423	62,539
Interest expense:				
Deposits	3,210	4,616	10,286	13,953
Fed funds purchased	14	15	31	53
Securities sold under agreements to repurchase	89	76	257	184
Federal Home Loan Bank advances	622	917	1,703	2,565
Subordinated debentures	869	884	2,591	2,642
Total interest expense	4,804	6,508	14,868	19,397
Net interest income	17,214	14,717	49,555	43,142
Provision for loan losses	2,695	3,475	7,774	7,300
Net interest income after provision for loan losses	14,519	11,242	41,781	35,842
Non-interest income:				
Investment management and trust services	3,045	2,731	9,538	8,203
Service charges on deposit accounts	2,200	2,120	6,203	5,969
Bankcard transaction revenue	837	745	2,451	2,151
Gains on sales of mortgage loans held for sale	601	667	1,431	1,610
Gains on sales of securities available for sale	159		159	
Brokerage commissions and fees	525	436	1,484	1,258
Bank owned life insurance income	251	249	742	737
Other	721	1,253	2,350	2,898
Total non-interest income	8,339	8,201	24,358	22,826
Non-interest expenses:				
Salaries and employee benefits	8,197	7,569	24,605	22,638
Net occupancy expense	1,136	1,060	3,708	3,081
Data processing expense	1,119	1,091	3,578	3,370
Furniture and equipment expense	316	316	951	915
FDIC insurance expense	498	471	1,500	2,138
Other	2,720	2,521	7,903	7,185
Total non-interest expenses	13,986	13,028	42,245	39,327
Income before income taxes	8,872	6,415	23,894	19,341
Income tax expense	2,507	2,016	6,992	5,917
Net income	6,365	4,399	16,902	13,424
Net income per share:				
Basic	$ 0.46	$ 0.32	$ 1.24	$ 0.99
Diluted	$ 0.46	$ 0.32	$ 1.23	$ 0.98

Average common shares:				
Basic	13,701	13,584	13,679	13,550
Diluted	13,807	13,702	13,770	13,694

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

S.Y. BANCORP, INC. AND SUBSIDIARY

Unaudited Condensed Consolidated Statements of Cash Flows

For the nine months ended September 30, 2010 and 2009

(In thousands)

	2010	2009
Operating activities:		
Net income	$ 16,902	$ 13,424
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	7,774	7,300
Depreciation, amortization and accretion, net	2,383	1,799
Deferred income tax benefit	(1,975)	(1,762)
Gain on sale of securities available for sale	(159)	
Gain on sales of mortgage loans held for sale	(1,431)	(1,610)
Origination of mortgage loans held for sale	(109,844)	(188,512)
Proceeds from sale of mortgage loans held for sale	114,606	187,952
Bank owned life insurance income	(742)	(737)
Increase in value of private investment fund	(347)	(559)
Loss on the sale of premises and equipment	2	
Loss on the sale of other real estate	24	2
Stock compensation expense	704	509
Excess tax benefits from share-based compensation arrangements	(89)	(123)
Reversal of valuation of mortgage servicing rights		(176)
Increase in accrued interest receivable and other assets	(7,135)	(386)
(Decrease) increase in accrued interest payable and other liabilities	(1,609)	300
Net cash provided by operating activities	19,064	17,421
Investing activities:		
Purchases of securities available for sale	(190,473)	(187,081)
Proceeds from sale of securities available for sale	27,064	
Proceeds from maturities of securities available for sale	137,623	126,869
Proceeds from maturities of securities held to maturity	11	6
Net increase in loans	(61,750)	(66,016)
Purchases of premises and equipment	(4,640)	(2,363)
Proceeds from disposal of premises and equipment	3	
Proceeds from sale of foreclosed assets	1,111	251
Net cash used in investing activities	(91,051)	(128,334)
Financing activities:		
Net increase in deposits	44,595	90,826
Net increase in securities sold under agreements to repurchase and federal funds purchased	13,343	14,314
Net (decrease) increase in other short-term borrowings	(577)	240
Proceeds from Federal Home Loan Bank advances	20,000	20,460
Repayments of Federal Home Loan Bank advances	(8)	(4)
Repayments of subordinated debentures	(30)	(30)
Issuance of common stock for options and dividend reinvestment plan	518	1,446
Excess tax benefits from share-based compensation arrangements	89	123
Common stock repurchases	(81)	(300)
Cash dividends paid	(6,964)	(6,900)
Net cash provided by financing activities	70,885	120,175
Net (decrease) increase in cash and cash equivalents	(1,102)	9,262
Cash and cash equivalents at beginning of period	32,424	27,113

Cash and cash equivalents at end of period	$	31,322	$	36,375
Supplemental cash flow information:				
Income tax payments	$	6,355	$	6,855
Cash paid for interest		14,878		19,452
Supplemental non-cash activity:				
Transfers from loans to other real estate owned	$	4,579	$	633

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

S.Y. BANCORP, INC. AND SUBSIDIARY

Unaudited Condensed Consolidated Statement of Changes in Stockholders Equity

For the nine months ended September 30, 2010

(In thousands, except per share data)

	Common stock Number of shares	Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total
Balance December 31, 2009	13,607	$ 6,244	$ 9,729	$ 135,442	$ 2,199	$ 153,614
Net income				16,902		16,902
Change in accumulated other comprehensive income, net of tax					2,850	2,850
Stock compensation expense			704			704
Stock issued for stock options exercised and dividend reinvestment plan	59	198	600			798
Stock issued for non-vested restricted stock	54	181	961	(1,142)		
Cash dividends, $0.51 per share				(6,987)		(6,987)
Shares repurchased or cancelled	(13)	(44)	(260)	32		(272)
Balance September 30, 2010	13,707	$ 6,579	$ 11,734	$ 144,247	$ 5,049	$ 167,609

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

S.Y. BANCORP, INC. AND SUBSIDIARY

Unaudited Condensed Consolidated Statements of Comprehensive Income

For the three and nine months ended September 30, 2010 and 2009

(In thousands)

	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Net income	$ 6,365	$ 4,399	$ 16,902	$ 13,424
Other comprehensive income, net of tax:				
Unrealized gains on securities available for sale:				
Unrealized gains arising during the period (net of tax of $682, $712, $1,590 and $261, respectively)	1,266	1,323	2,953	485
Reclassification adjustment for securities gains realized in income (net of tax of ($56), $0, ($56), and $0, respectively)	(103)		(103)	
Other comprehensive income	1,163	1,323	2,850	485
Comprehensive income	$ 7,528	$ 5,722	$ 19,752	$ 13,909

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

S.Y. BANCORP, INC. AND SUBSIDIARY

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all information and footnotes required by U.S. generally accepted accounting principles (US GAAP) for complete financial statements. The consolidated financial statements of S.Y. Bancorp, Inc. (Bancorp) and its subsidiary reflect all adjustments (consisting only of adjustments of a normal recurring nature) which are, in the opinion of management, necessary for a fair presentation of financial condition and results of operations for the interim periods.

The consolidated financial statements include the accounts of S.Y. Bancorp, Inc. and its wholly-owned subsidiary, Stock Yards Bank & Trust Company (Bank). S.Y. Bancorp Capital Trust II is a Delaware statutory trust that is a wholly-owned unconsolidated finance subsidiary of S.Y. Bancorp, Inc. Significant intercompany transactions and accounts have been eliminated in consolidation.

A description of other significant accounting policies is presented in the notes to the Consolidated Financial Statements for the year ended December 31, 2009 included in S.Y. Bancorp, Inc. s Annual Report on Form 10-K. Certain reclassifications have been made in the prior year financial statements to conform to current year classifications.

Interim results for the three and nine month periods ended September 30, 2010 are not necessarily indicative of the results for the entire year.

Critical Accounting Policies

Management has identified the accounting policy related to the allowance for loan losses as critical to the understanding of Bancorp s results of operations and discussed this conclusion with the Audit Committee of the Board of Directors. Since the application of this policy requires significant management assumptions and estimates, it could result in materially different amounts to be reported if conditions or underlying circumstances were to change. Assumptions include many factors such as changes in borrowers financial condition which can change quickly or historical loss ratios related to certain loan portfolios which may or may not be indicative of future losses. To the extent that management s assumptions prove incorrect, the results from operations could be materially affected by a higher or lower provision for loan losses. The accounting policy related to the allowance for loan losses is applicable to the commercial banking segment of Bancorp.

Additionally, management has identified the accounting policy related to accounting for income taxes as critical to the understanding of Bancorp s results of operations and discussed this conclusion with the Audit Committee of the Board of Directors. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity s financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in Bancorp s financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences, including the effects of periodic IRS and state agency examinations, could materially impact Bancorp s financial position and its results from operations.

Table of Contents

(2) Securities

The amortized cost, unrealized gains and losses, and fair value of securities available for sale follow:

September 30, 2010 **Securities available for sale** **(in thousands)**	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
Government sponsored enterprise obligations	$ 140,326	$ 3,671	$ 1	$ 143,996
Mortgage-backed securities	57,265	2,596	45	59,816
Obligations of states and political subdivisions	50,842	1,918	2	52,758
Trust preferred securities of financial institutions	1,250		14	1,236
Total securities available for sale	$ 249,683	$ 8,185	$ 62	$ 257,806

December 31, 2009 **Securities available for sale** **(in thousands)**	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
U.S. Treasury and other U.S. government obligations	$ 3,000	$ 19	$	$ 3,019
Government sponsored enterprise obligations	122,761	2,006	79	124,688
Mortgage-backed securities	65,179	1,519	17	66,681
Obligations of states and political subdivisions	32,298	689	175	32,812
Trust preferred securities of financial institutions	1,250		225	1,025
Total securities available for sale	$ 224,488	$ 4,233	$ 496	$ 228,225

Table of Contents

The amortized cost, unrealized gains and losses, and fair value of securities held to maturity follow:

September 30, 2010 **Securities held to maturity** **(in thousands)**	**Amortized** **Cost**		**Unrealized** **Gains**		**Losses**		**Fair** **Value**
Mortgage-backed securities	$	24	$	1	$	$	25

December 31, 2009 **Securities held to maturity** **(in thousands)**	**Amortized** **Cost**		**Unrealized** **Gains**		**Losses**		**Fair** **Value**
Mortgage-backed securities	$	35	$	2	$	$	37

In addition to the available for sale and held to maturity portfolios, investment securities held by Bancorp include certain securities which are not readily marketable. This category includes holdings of Federal Home Loan Bank of Cincinnati (FHLB) stock which are required for borrowing availability, and are classified as restricted securities. Other securities consist of a Community Reinvestment Act (CRA) investment which matures in 2014, and is fully collateralized with a government agency security of similar duration. These securities are carried at cost as follows:

Federal Home Loan Bank stock and other securities **(in thousands)**		**September 30,** **2010**		**December 31,** **2009**
Federal Home Loan Bank stock	$	4,771	$	4,546
Other securities		1,001		1,001
Total Federal Home Loan Bank stock and other securities	$	5,772	$	5,547

Table of Contents

A summary of securities as of September 30, 2010 based on contractual maturity is presented below. Actual maturities may differ from contractual maturities because some issuers have the right to call or prepay obligations.

(In thousands)	Securities Available for Sale Amortized Cost	Securities Available for Sale Fair Value	Securities Held to Maturity Amortized Cost	Securities Held to Maturity Fair Value
Due within one year	$ 73,181	$ 73,198	$	$
Due within one year through five years	83,821	86,662	6	6
Due within five years through ten years	37,548	39,899	16	17
Due after ten years	55,133	58,047	2	2
	$ 249,683	$ 257,806	$ 24	$ 25

Securities with unrealized losses at September 30, 2010 and December 31, 2009, not recognized in income are as follows:

(In thousands)	Less than 12 months Fair Value	Less than 12 months Unrealized Losses	12 months or more Fair Value	12 months or more Unrealized Losses	Total Fair Value	Total Unrealized Losses
September 30, 2010						
Government sponsored enterprise obligations	$ 49,999	$ 1	$	$	$ 49,999	1
Mortgage-backed securities	3,983	45			3,983	45
Obligations of states and political subdivisions	1,120	2			1,120	2
Trust preferred securities of financial institutions	1,236	14			1,236	14
Total temporarily impaired securities	$ 56,338	$ 62	$	$	$ 56,338	$ 62
December 31, 2009						
Government sponsored enterprise obligations	$ 13,402	$ 79	$	$	$ 13,402	$ 79
Mortgage-backed securities	9,692	17			9,692	17
Obligations of states and political subdivisions	8,084	175			8,084	175
Trust preferred securities of financial institutions			1,025	225	1,025	225
Total temporarily impaired securities	$ 31,178	$ 271	$ 1,025	$ 225	$ 32,203	$ 496

Table of Contents

In the third quarter of 2010, for tax planning purposes, Bancorp sold securities with a cost of $26,905,000, resulting in gains totaling $159,000. There were no sales of securities in the same period of 2009.

The investment portfolio includes a significant level of obligations of states and political subdivisions. The issuers of the bonds are generally school districts or essential-service public works projects. The bonds are concentrated in Kentucky, Indiana and Ohio. Each of these securities has a rating of A or better by a recognized bond rating agency.

Unrealized losses on Bancorp s investment securities portfolio have not been recognized in income because the securities are of high credit quality, the decline in fair values is largely due to changes in the prevailing interest rate and credit environment since the purchase date, management does not intend to sell the investments, and it is not likely that the Bancorp will be required to sell the investments before recovery of their amortized cost bases, which may be maturity. The fair value is expected to recover as the securities reach their maturity date and/or the interest rate and credit environment returns to conditions similar to when the securities were purchased. These investments consist of 7 and 14 separate investment positions as of September 30, 2010 and December 31, 2009 that are not considered other-than-temporarily impaired. Based on these detailed reviews, Bancorp has not recorded other-than-temporary losses on any securities held at September 30, 2010.

As of September 30, 2010, Bancorp had no securities which had been impaired for 12 months or longer. As of September 30, 2010, Bancorp had one trust preferred security with a credit rating below investment grade Caa1 by Moody s Investor Service. This security had an amortized cost of $1,000,000, a carrying value of $996,400, and an unrealized loss of $3,600. Management evaluates the impairment of securities on a quarterly basis, considering various factors including issuer financial condition, agency rating, payment prospects, impairment duration and general industry condition. Based on the evaluation as of September 30, 2010, management is of the opinion that none of the securities is other-than-temporarily impaired. Management does not intend to sell the investments, and it is not likely that Bancorp will be required to sell the investments before recovery of their amortized cost bases, which may be maturity.

(3) Stock-Based Compensation

The fair value of all new and modified awards granted, net of estimated forfeitures, is recognized as compensation expense. These forfeiture estimates are based on historical experience.

Bancorp currently has one stock-based compensation plan. Initially, in the 2005 Stock Incentive Plan, there were 735,000 shares of common stock reserved for issuance of stock based awards. At Bancorp s Annual Meeting of Shareholders held on April 21, 2010, shareholders approved a proposal to amend the 2005 Stock Incentive Plan to reserve an additional 700,000 shares of common stock for issuance under the plan. As of September 30, 2010, there were 770,698 shares available for future awards.

Bancorp s 1995 Stock Incentive Plan expired in 2005; however, options granted under this plan expire as late as 2015. Options and stock appreciation rights (SARs) granted generally have been subject to a vesting schedule of 20% per year. Prior to 2009, those granted to certain executive officers vested six months after grant date. Restricted shares generally vest over three to five years, with limited exceptions of shorter vesting schedules due to anticipated retirement. All awards under both plans were granted at an exercise price equal to the market value of common stock at the time of grant and expire ten years after the grant date.

Table of Contents

Bancorp has recognized stock-based compensation expense, within salaries and employee benefits in the consolidated statements of income, as follows:

	For three months ended September 30, 2010	For three months ended September 30, 2009	For Nine months ended September 30, 2010	For Nine months ended September 30, 2009
Stock-based compensation expense before income taxes	$ 248,900	$ 181,000	$ 704,100	$ 509,000
Deferred tax benefit	87,100	63,000	246,400	178,000
Reduction of net income	$ 161,800	$ 118,000	$ 457,700	$ 331,000

Bancorp expects to record an additional $249,000 of stock-based compensation expense in 2010. As of September 30, 2010, Bancorp has $2,613,000 of unrecognized stock-based compensation expense that will be recorded as compensation expense over the next five years as awards vest. Bancorp received cash of $507,000 and $897,000 from the exercise of options during the first nine months of 2010 and 2009, respectively.

The fair value of Bancorp s stock options and SARs is estimated at the date of grant using the Black-Scholes option pricing model, a leading formula for calculating the value of stock options. This model requires the input of subjective assumptions, changes to which can materially affect the fair value estimate. The fair value of restricted shares is determined by Bancorp s closing stock price on the date of grant. The following assumptions were used in SAR/option valuations at the grant date in each year:

	2010	2009
Dividend yield	2.18%	2.11%
Expected volatility	23.87	23.59
Risk free interest rate	3.57	3.11
Forfeitures	5.96	5.96
Expected life of options and SARs (in years)	7.6	7.7

The expected life of options is based on actual experience of past like-term awards. All outstanding options have a 10-year contractual term. Bancorp evaluated historical exercise and post-vesting termination behavior when determining the expected life of options and SARs.

The dividend yield and expected volatility are based on historical information corresponding to the expected life of awards granted. The expected volatility is the volatility of the underlying shares for the expected term on a monthly basis. The risk free interest rate is the implied yield currently available on U.S. Treasury issues with a remaining term equal to the expected life of the awards.

Table of Contents

A summary of stock option and SARs activity and related information for the nine months ended September 30, 2010 follows. The number of options and SARs and aggregate intrinsic value are stated in thousands.

	Options and SARs	Exercise Price	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Fair Value	Average Remaining Contractual Life
At December 31, 2009						
Vested and exercisable	730	$ 9.82-26.83	$ 20.50	$ 1,664	$ 4.52	4.42
Unvested	276	20.90-26.83	23.81		5.41	7.93
Total outstanding	1,006	9.82-26.83	21.41	1,664	4.76	5.38
Granted	85	21.03	21.03	322	5.31	
Exercised	(59)	9.82-22.81	11.81	663	2.40	
Forfeited	(14)	22.14-26.83	24.17	15	5.50	
At September 30, 2010						
Vested and exercisable	744	9.82-26.83	21.54	2,633	4.79	4.22
Unvested	274	21.03-26.83	22.85	618	5.36	7.98
Total outstanding	1,018	9.82-26.83	21.89	$ 3,251	4.94	5.23
Vested during nine months ended September 30, 2010	80	22.14-26.83	23.93	$ 12	5.52	

The aggregate intrinsic value of stock options exercised was calculated as the difference in the closing price of Bancorp s common shares on the date of exercise and the exercise price, multiplied by the number of shares exercised.

The weighted average Black-Scholes fair values of options and SARs granted in 2010 and 2009 were $5.31 and $5.36, respectively.

In the first quarter of 2010, Bancorp granted 84,558 SARs at the current market price of $21.03 and a Black-Scholes fair value of $5.31. Also, in the first quarter of 2010, Bancorp granted 54,292 shares of common stock at the current market price of $21.03. No SARs or common stock grants were awarded in the second or third quarters of 2010.

Table of Contents

(4) Allowance for Loan Losses and Impaired Loans

An analysis of the changes in the allowance for loan losses for the nine months ended September 30, 2010 and 2009 follows (in thousands):

	2010	2009
Beginning balance January 1,	$ 20,000	$ 15,381
Provision for loan losses	7,774	7,300
Loans charged off	(3,992)	(3,317)
Recoveries	651	475
Ending balance September 30,	$ 24,433	$ 19,839

Information about impaired loans follows (in thousands):

	September 30, 2010	December 31, 2009
Principal balance of impaired loans	$ 12,029	$ 11,208
Impaired loans with a valuation allowance	6,052	8,688
Amount of valuation allowance	1,452	1,676
Impaired loans with no valuation allowance	5,977	2,520
Average balance of impaired loans for the period	12,386	7,005

(5) Federal Home Loan Bank Advances

The Bank had outstanding borrowings of $80.4 million, at September 30, 2010, comprised of seven separate fixed rate advances as detailed in the table below (in thousands).

Amount	Fixed rate	Amortization	Maturity	Call Feature	Next Call Date
$ 20,000	3.69%	None	December 2010	Non callable	
20,000	4.58%	None	May 2012	Quarterly	November 2010
10,000	1.99%	None	April 2012	Non callable	
10,000	2.67%	None	April 2014	Non callable	
10,000	2.18%	None	May 2014	Non callable	
10,000	1.94%	None	August 2015	Non callable	
445	2.40%	15 Year	April 2024	Non callable	
$ 80,445					

For the first six advances, interest payments are due monthly, with principal due at maturity. For the seventh advance, principal and interest payments are due monthly based on a 15 year amortization schedule. The weighted average rate of these seven advances was 3.16% at September 30, 2010. Advances from the FHLB are collateralized by certain commercial and residential real estate mortgage loans under a blanket mortgage collateral agreement and FHLB stock.

The Bank s agreement with the FHLB of Cincinnati enables the Bank to borrow up to an additional $130.6 million as of September 30, 2010 under terms to be established at the time of the advance. The Bank also has standby letters of credit from the FHLB totaling $14.8 million outstanding at September 30, 2010. Under Kentucky law, customer cash balances in Investment Management and Trust accounts, may be retained as deposits in the Bank. Kentucky law requires these deposit accounts to be backed by some form

Table of Contents

of collateral above the $250,000 per account protection provided by the FDIC. Standby letters of credit from the FHLB collateralize these accounts beyond the FDIC protection as required by Kentucky law.

(6) Goodwill and Intangible Assets

US GAAP requires that goodwill and intangible assets with indefinite useful lives be tested for impairment at least annually. Annual evaluations have resulted in no charges for impairment. Bancorp currently has goodwill from the acquisition of a bank in southern Indiana in the amount of $682,000. This goodwill is assigned to the commercial banking segment of Bancorp.

Mortgage servicing rights (MSRs) are amortized in proportion to and over the period of estimated net servicing income, considering appropriate prepayment assumptions. MSRs are evaluated quarterly for impairment by comparing the carrying value to the fair value. The estimated fair values of MSRs at September 30, 2010 and December 31, 2009 were $1,796,000 and $2,475,000, respectively. The total outstanding principal balances of loans serviced for others were $236,341,000 and $194,414,000 at September 30, 2010, and December 31, 2009 respectively. Changes in the net carrying amount of MSRs for the nine months ended September 30, 2010 and 2009 are shown in the following table.

(in thousands)		2010		2009
Balance at beginning of period	$	1,616	$	426
Originations		449		1,100
Amortization		(370)		(190)
Impairment reversal				176
Balance at September 30	$	1,695	$	1,512

(7) Defined Benefit Retirement Plan

The Bank sponsors an unfunded, non-qualified, defined benefit retirement plan for certain key officers. Benefits vest based on years of service. The actuarially determined pension costs are expensed and accrued over the service period, and benefits are paid from the Bank s assets. The Bank maintains life insurance policies on certain current and former executives, the income from which will help to offset the cost of benefits. The net periodic benefits costs, which include interest cost and amortization of net losses, totaled $31,000 and $32,000 for the three months ended September 30, 2010 and 2009, respectively. For the nine months ended September 30, 2010 and 2009, the net periodic benefit costs totaled $93,000 and $97,000, respectively.

(8) Commitments and Contingent Liabilities

As of September 30, 2010, Bancorp had various commitments outstanding that arose in the normal course of business, including standby letters of credit and commitments to extend credit, which are properly not reflected in the consolidated financial statements. In management s opinion, commitments to extend credit of $337,181,000 including standby letters of credit of $12,681,000 represent normal banking transactions, and no significant losses are anticipated to result from these commitments as of September 30, 2010. Commitments to extend credit were $379,075,000, including letters of credit of $26,655,000, as of December 31, 2009. Bancorp s exposure to credit loss in the event of nonperformance by the other party to these commitments is represented by the contractual amount of these instruments. Bancorp uses the same credit and collateral policies in making commitments and conditional guarantees as for on-balance sheet instruments.

Table of Contents

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Commitments to extend credit are mainly made up of commercial lines of credit, construction and development loans and home equity credit lines. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Bancorp evaluates each customer s creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by Bancorp upon extension of credit, is based on management s credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income producing commercial properties, residential properties and real estate under development.

Standby letters of credit and financial guarantees written are conditional commitments issued by Bancorp to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. Standby letters of credit generally have maturities of up to five years.

Bancorp has entered into agreements to guarantee the performance of several customers contracts with other financial institutions. Bancorp will make payments under these agreements if a customer defaults on its obligations to the other financial institutions. The terms of the agreements range from 1 to 29 months. The maximum potential future payment guaranteed by Bancorp cannot be readily estimated because it is dependent upon the fair value of the contracts at the time of default. If an event of default on all contracts had occurred at September 30, 2010, Bancorp would have been required to make payments of approximately $2,980,000. No payments have ever been required as a result of default on these contracts. These agreements are normally collateralized generally with real properties, equipment, inventories and receivables by the customer, which limits Bancorp s credit risk associated with the agreements.

(9) Preferred Stock

At Bancorp s 2003 annual meeting of shareholders, the shareholders approved an amendment to the Articles of Incorporation to create a class of preferred stock and authorize 1,000,000 shares of this preferred stock with no par value. The relative rights, preferences and other terms of this stock or any series within the class will be determined by the Board of Directors prior to any issuance. Some of this preferred stock will be used in connection with a shareholders rights plan upon the occurrence of certain triggering events. None of this stock had been issued as of September 30, 2010.

Table of Contents

(10) Net Income Per Share

The following table reflects, for the three and nine months ended September 30, 2010 and 2009, net income (the numerator) and average shares outstanding (the denominator) for the basic and diluted net income per share computations:

	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Net income, basic and diluted	$ 6,365	$ 4,399	$ 16,902	$ 13,424
Average shares outstanding	13,701	13,584	13,679	13,550
Effect of dilutive securities	106	118	91	144
Average shares outstanding including dilutive securities	13,807	13,702	13,770	13,694
Net income per share, basic	$ 0.46	$ 0.32	$ 1.24	$ 0.99
Net income per share, diluted	$ 0.46	$ 0.32	$ 1.23	$ 0.98

(11) Segments

The Bank s, and thus Bancorp s, principal activities include commercial banking and investment management and trust. Commercial banking provides a full range of loan and deposit products to individuals, consumers and businesses. Commercial banking also includes the Bank s mortgage banking and securities brokerage activity. Investment management and trust provides wealth management services including investment management, trust and estate administration, retirement plan services and financial planning.

The financial information for each business segment reflects that which is specifically identifiable or allocated based on an internal allocation method. Principally, all of the net assets of Bancorp are involved in the commercial banking segment. Income taxes are allocated to the investment management and trust segment based on the marginal federal tax rate since all activity giving rise to the difference between marginal and effective tax rates occurs in the commercial banking segment. The measurement of the performance of the business segments is based on the management structure of the Bank and is not necessarily comparable with similar information for any other financial institution. The information presented is also not indicative of the segments operations, if they were independent entities.

Table of Contents

Selected financial information by business segment for the three and nine month periods ended September 30, 2010 and 2009 follows:

(In thousands)	Three months ended September 30 2010	2009	Nine Months ended September 30 2010	2009
Net interest income				
Commercial banking	$ 17,187	$ 14,681	$ 49,471	$ 43,015
Investment management and trust	27	36	84	127
Total	$ 17,214	$ 14,717	$ 49,555	$ 43,142
Provision for loan losses:				
Commercial banking	$ 2,695	$ 3,475	$ 7,774	$ 7,300
Investment management and trust				
Total	$ 2,695	$ 3,475	$ 7,774	$ 7,300
Non-interest income:				
Commercial banking	$ 5,294	$ 5,470	$ 14,820	$ 14,623
Investment management and trust	3,045	2,731	9,538	8,203
Total	$ 8,339	$ 8,201	$ 24,358	$ 22,826
Non-interest expense:				
Commercial banking	$ 12,284	$ 11,501	$ 36,800	$ 34,571
Investment management and trust	1,702	1,527	5,445	4,756
Total	$ 13,986	$ 13,028	$ 42,245	$ 39,327
Tax expense				
Commercial banking	$ 2,028	$ 1,582	$ 5,530	$ 4,666
Investment management and trust	479	434	1,462	1,251
Total	$ 2,507	$ 2,016	$ 6,992	$ 5,917
Net income:				
Commercial banking	$ 5,474	$ 3,593	$ 14,187	$ 11,101
Investment management and trust	891	806	2,715	2,323
Total	$ 6,365	$ 4,399	$ 16,902	$ 13,424

(12) Income Taxes

US GAAP provides guidance on financial statement recognition and measurement of tax positions taken, or expected to be taken, in tax returns. As of September 30, 2010 and December 31, 2009 the gross amount of unrecognized tax benefits was $230,000. If recognized, all of the tax benefits would increase net income, resulting in a decrease of the effective tax rate. The amount of unrecognized tax benefits may increase or decrease in the future for various reasons including adding amounts for current tax year positions, expiration of open income tax returns due to statutes of limitation, changes in management s judgment about the level of uncertainty, status of examination, litigation and legislative activity and the addition or elimination of uncertain tax positions.

Table of Contents

Bancorp s policy is to report interest and penalties, if any, related to unrecognized tax benefits in income tax expense. As of September 30, 2010 and December 31, 2009, the amount accrued for the potential payment of interest and penalties was $20,000.

(13) Derivative Financial Instruments

Bancorp typically manages its interest rate risk without the use of hedging instruments, and currently does not have derivative financial instruments employed for any reason except for the accommodation of customers. Bancorp enters into free-standing interest rate swaps for the benefits of its commercial customers who desire to hedge their exposure to changing interest rates. Bancorp hedges its interest rate exposure on commercial customer transactions by entering into offsetting swap agreements with approved reputable independent counterparties with substantially matching terms. Because of matching terms of offsetting contracts and the collateral provisions mitigating any non-performance risk, changes in fair value subsequent to initial recognition are expected to have an insignificant effect on earnings. Exchanges of cash flows related to the interest rate swap agreements for the third quarter of 2010 were offsetting and therefore had no effect on Bancorp s earnings or cash flows.

At September 30, 2010, Bancorp s interest rate swaps are recognized as other assets and liabilities in the consolidated balance sheets at fair value. Bancorp s derivative instruments have not been designated as hedging instruments. These undesignated derivative instruments are recognized on the consolidated balance sheet at fair value.

The interest rate swap agreements derive their value from underlying interest rates. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations, payments, and the value of the derivative are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Bancorp is exposed to credit-related losses in the event of nonperformance by the counterparties to these agreements. Bancorp controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail their obligations.

At September 30, 2010 and December 31, 2009, Bancorp had outstanding interest rate swap contracts as follows:

	Receiving		Paying	
(dollar amounts in thousands)	**September 30, 2010**	**December 31, 2009**	**September 30, 2010**	**December 31, 2009**
Notional amount	$ 5,339	$ 5,500	$ 5,339	$ 5,500
Weighted average maturity	8.4	9.1	8.4	9.1
Fair value	$ (433)	$ (94)	$ 433	$ 94

(14) Fair Value Measurements

Bancorp adopted the provisions of the authoritative guidance for fair value measurements. This guidance is definitional and disclosure oriented and addresses how companies should approach measuring fair value when required by US GAAP; it does not create or modify any current US

GAAP requirements to apply fair value accounting. The guidance prescribes various disclosures about financial statement categories and amounts which are measured at fair value, if such disclosures are not already specified elsewhere in US GAAP.

Table of Contents

The authoritative guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between participants at the measurement date. The guidance also establishes a hierarchy to group assets and liabilities carried at fair value in three levels based upon the markets in which the assets and liabilities trade and the reliability of assumptions used to determine fair value. These levels are:

- Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.

- Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

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

Bancorp s policy is to maximize the use of observable inputs and minimize the use of unobservable inputs in fair value measurements. Where there exists limited or no observable market data, Bancorp uses its own estimates generally considering characteristics of the asset/liability, the current economic and competitive environment and other factors. For this reason, results cannot be determined with precision and may not be realized on an actual sale or immediate settlement of the asset or liability.

Bancorp s investment securities available for sale are recorded at fair value on a recurring basis. Other accounts including mortgage loans held for sale, mortgage servicing rights, impaired loans and other real estate owned may be recorded at fair value on a non-recurring basis, generally in the application of lower of cost or market adjustments or write-downs of specific assets.

The portfolio of investment securities available for sale is comprised of debt securities of the U.S. Treasury and other U.S. government-sponsored corporations, mortgage-backed securities, obligations of state and political subdivisions, and trust preferred securities of other banks. Trust preferred securities are priced using quoted prices of identical securities in an active market. These measurements are classified as Level 1 in the hierarchy above. All other securities are priced using standard industry models or matrices with various assumptions such as yield curves, volatility, prepayment speeds, default rates, time value, credit rating and market prices for the instruments. These assumptions are generally observable in the market place and can be derived from or supported by observable data. These measurements are classified as Level 2 in the hierarchy above.

Interest rate swaps are valued using primarily Level 2 inputs. Fair value measurements are obtained from an outside pricing service. Prices obtained are generally based on dealer quotes, benchmark forward yield curves, and other relevant observable market data. For purposes of potential valuation adjustments to derivative positions, Bancorp evaluates the credit risk of its counterparties as well as its own credit risk. To date, Bancorp has not realized any losses due to a counterparty s inability to perform and the change in value of derivative assets and liabilities attributable to credit risk was not significant during 2010.

Table of Contents

Below are the carrying values of assets measured at fair value on a recurring basis (in thousands).

	Fair Value at September 30, 2010			
(In thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**
Assets				
Investment securities available for sale				
Government sponsored enterprise obligations	$ 143,996	$	$ 143,996	$
Mortgage-backed securities	59,816		59,816	
Obligations of states and political subdivisions	52,758		52,758	
Trust preferred securities of financial institutions	1,236	1,236		
Total investment securities available for sale	257,806	1,236	256,570	
Interest rate swaps	433		433	
Total assets	$ 258,239	$ 1,236	$ 257,003	$
Liabilities				
Interest rate swaps	$ 433	$	$ 433	$

Table of Contents

(In thousands)	Fair value at December 31, 2009 Total	Level 1	Level 2	Level 3
Assets				
Investment securities available for sale				
U.S. Treasury and other U.S. government obligations	$ 3,019	$	$ 3,019	$
Government sponsored enterprise obligations	124,688		124,688	
Mortgage-backed securities	66,681		66,681	
Obligations of states and political subdivisions	32,812		32,812	
Trust preferred securities of financial institutions	1,025	1,025		
Total investment securities available for sale	228,225	1,025	227,200	
Interest rate swaps	94		94	
Total assets	$ 228,319	$ 1,025	$ 227,294	$
Liabilities				
Interest rate swaps	$ 94	$	$ 94	$

Mortgage loans held for sale are carried at the lower of cost or market value. The portfolio is comprised of residential real estate loans and fair value is based on specific prices of underlying contracts for sales to investors. These measurements are classified as Level 2. Because the fair value of the loans held for sale exceeded their carrying value, they are not included in the table for September 30, 2010 or December 31, 2009.

Mortgage servicing rights (MSRs) are recorded at fair value upon capitalization, are amortized to correspond with estimated servicing income, and are periodically assessed for impairment based on fair value at the reporting date. Fair value is based on a valuation model that calculates the present value of estimated net servicing income. The model incorporates assumptions that market participants would use in estimating future net servicing income. These measurements are classified as Level 3. At September 30, 2010 and December 31, 2009 there was no valuation allowance for the mortgage servicing rights, as the fair value exceeded the cost. Accordingly, the MSRs are not included in the table for 2010 or 2009.

Bancorp s investment in a bank in one of Bancorp s expansion markets, included in other assets, is recorded as an equity-method investment. As of September 30, 2010, the carrying value of the investment is $520,000, and is not included in the table below as the fair value of the investment exceeds the cost. Because Bancorp evaluated this investment based on a quoted price for this security in a market that is generally not active, the measurement was classified as Level 2.

Table of Contents

Other real estate owned, which is carried at the lower of cost or fair value, is periodically assessed for impairment based on fair value at the reporting date. Fair value is determined from external appraisals using judgments and estimates of external professionals. Many of these inputs are not observable and, accordingly, these measurements are classified as Level 3. At September 30, 2010 and December 31, 2009, the carrying value of other real estate owned was $4,943,000 and $1,556,000, respectively. Other real estate owned is not included in either table below, as the fair value of the properties exceeded their carrying value at September 30, 2010 and December 31, 2009.

For impaired loans in the table below, the fair value is calculated as the carrying value of loans with a specific valuation allowance, less the specific allowance. The losses represent the change in the specific allowances for the period indicated.

Below are the carrying values of assets measured at fair value on a non-recurring basis (in thousands).

	Fair value at September 30, 2010				Losses for 9 month period ended
(in thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**	**September 30, 2010**
Impaired loans	$ 4,600	$	$	$ 4,600	$ (942)

	Fair value at December 31, 2009				Losses for 9 month period ended
(in thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**	**September 30, 2009**
Impaired loans	$ 7,012	$	$	$ 7,012	$ (918)

Table of Contents

(15) Fair Value of Financial Instruments

The estimated fair values of financial instruments are as follows:

	September 30, 2010		December 31, 2009	
(In thousands)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets				
Cash and short-term investments	$ 31,322	$ 31,322	$ 32,424	$ 32,424
Mortgage loans held for sale	9,918	10,162	13,249	13,268
Securities	257,830	257,831	228,260	228,262
Federal Home Loan Bank stock and other securities	5,772	5,772	5,547	5,547
Loans, net	1,464,965	1,484,382	1,415,462	1,440,374
Accrued interest receivable	5,861	5,861	5,745	5,745
Interest rate swaps	433	433	94	94
Financial liabilities				
Deposits	$ 1,462,779	$ 1,478,293	$ 1,418,184	$ 1,429,863
Short-term borrowings	85,414	85,415	72,648	72,765
Long-term borrowings	121,345	122,731	101,383	109,959
Accrued interest payable	417	417	427	427
Interest rate swaps	433	433	94	94
Off balance sheet financial instruments				
Commitments to extend credit				
Standby letters of credit		(190)		(400)

Management used the following methods and assumptions to estimate the fair value of each class of financial instrument for which it is practicable to estimate the value.

Cash, Short-term investments, Federal Home Loan Bank stock, Accrued interest receivable/payable and Short-term borrowings

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Securities

For securities, fair value equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities or dealer quotes.

Mortgage loans held for sale

The fair value of mortgage loans held for sale is determined by market quotes for each loan based on loan type, term, rate and size.

Table of Contents

Loans, net

The fair value of loans is estimated by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities (e.g. entrance price).

Interest rate swaps

Fair value measurements are obtained from an outside pricing service. Prices obtained are generally based on dealer quotes, benchmark forward yield curves, and other relevant observable market data.

Deposits

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-rate certificates of deposits is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities.

Long-term borrowings

The fair value of long-term borrowings is estimated by discounting the future cash flows using estimates of the current market rate for instruments with similar terms and remaining maturities.

Commitments to extend credit and standby letters of credit

The fair values of commitments to extend credit are estimated using fees currently charged to enter into similar agreements and the creditworthiness of the customers. The fair values of standby letters of credit are based on fees currently charged for similar agreements or the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date.

Limitations

The fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market exists for a significant portion of Bancorp s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Therefore, the calculated fair value estimates in many instances cannot be substantiated by comparison to independent markets and, in many cases, may not be realizable in a current sale of the instrument. Changes in assumptions could significantly affect the estimates.

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

This item discusses the results of operations for S.Y. Bancorp, Inc. (Bancorp or Company), and its subsidiary, Stock Yards Bank & Trust Company (Bank) for the three and nine months ended September 30, 2010 and compares these periods with the same periods of the previous year. Unless otherwise indicated, all references in this discussion to the Bank include Bancorp. In addition, the discussion describes the significant changes in the financial condition of Bancorp and the Bank that have occurred during the first nine months of 2010 compared to the year ended December 31, 2009. This discussion should be read in conjunction with the

Table of Contents

unaudited condensed consolidated financial statements and accompanying notes presented in Part 1, Item 1 of this report.

This report contains forward-looking statements under the Private Securities Litigation Reform Act that involve risks and uncertainties. Although Bancorp believes the assumptions underlying the forward-looking statements contained herein are reasonable, any of these assumptions could be inaccurate. Factors that could cause actual results to differ from results discussed in forward-looking statements include, but are not limited to the following: economic conditions both generally and more specifically in the markets in which Bancorp and the Bank operate; competition for Bancorp s customers from other providers of financial services; government legislation and regulation which change from time to time and over which Bancorp has no control; changes in interest rates; material unforeseen changes in liquidity, results of operations, or financial condition of Bancorp s customers; and other risks detailed in Bancorp s filings with the Securities and Exchange Commission, all of which are difficult to predict and many of which are beyond the control of Bancorp.

Overview of 2010 through September 30

Bancorp completed the third quarter and first nine months of 2010 with higher net income than the comparable periods of 2009 by 45% and 26%, respectively. The increases are due to loan growth, an improvement in net interest margin and increasing non-interest income. Diluted earnings per share for the third quarter and first nine months of 2010 increased 44% and 26% respectively.

As is the case with most banks, the primary source of Bancorp s revenue is net interest income and fees from various financial services provided to customers. Net interest income is the difference between interest income earned on loans, investment securities and other interest earning assets less interest expense on deposit accounts and other interest bearing liabilities. Loan volume and the interest rates earned on those loans are critical to overall profitability. Similarly deposit volume is crucial to funding loans and rates paid on deposits directly impact profitability. Business volumes are influenced by overall economic factors including market interest rates, business spending, consumer confidence and competitive conditions within the marketplace.

Year-over-year total loans increased $77 million or 5%, and this was the driving force for growth in interest income. Increased loan volume more than offset the negative effect of declining interest rates over the past year. Despite deposit growth to support loan growth, interest expense declined due to lower funding costs on deposits and borrowings. The average rate earned on assets decreased in the first nine months of 2010 compared to the same period in 2009 as the rates earned on loans and investments also declined. Rates paid on liabilities decreased more than rates decreased on earning assets, resulting in an increased net interest spread and net interest margin compared to the first nine months of 2009.

Distinguishing Bancorp from other similarly sized community banks is the magnitude of its investment management and trust revenue, making total non-interest income a continuing key contributor to earnings in the first nine months of 2010. Total non-interest income increased 7% in the first nine months of 2010 compared to the same period in 2009. The increase is due largely to increased income from investment management and trust services. Income from investment management and trust services, which constitutes the single largest component of non-interest income increased 16% for the first nine months of 2010 due to higher asset values and a modest increase in non-recurring estate fees. Revenue is earned as a percentage of the market value of the assets under management and therefore is tied directly to the broader market s overall performance. In addition, Bancorp experienced increases in service charges on deposit accounts, bankcard transaction income, and brokerage income. Partially offsetting the increases were decreases in gains on sales of mortgage loans held for sale as the volume of transactions in that area has declined from an all-time high in 2009.

Higher non-interest expenses for the first nine months of 2010 were reflected in salaries and benefits, occupancy expenses, data processing, and state bank taxes, partially offset by a decrease in FDIC insurance expense.

Table of Contents

Bancorp s third quarter efficiency ratio was 53.93% compared with 58.10% in the second quarter of 2010 and 56.20% in the third quarter last year.

Also impacting 2010 results, Bancorp s provision for loan losses was $7,774,000 for the first nine months of 2010 compared to $7,300,000 for the same period in 2009. The increased provision results from a consistent allowance methodology that is driven by risk ratings. Management continues to be concerned that the prolonged economic downturn and prospects for a slow recovery will continue to take a toll on Bancorp s loan portfolio and underlying collateral values, extending its impact to lending relationships that have to date not been identified. Bancorp s allowance for loan losses was 1.64% of total loans at September 30, 2010, compared with 1.39% of total loans at December 31, 2009, and 1.40% at September 30, 2009.

Tangible common equity (TCE), a non-GAAP measure, is a measure of a company s capital which is useful in evaluating the quality and adequacy of capital. The ratio of tangible common equity to total tangible assets was 8.88% as of September 30, 2010, compared to 8.54% at December 31, 2009. See the Non-GAAP Financial Measures section for details on reconcilement to US GAAP measures.

The following sections provide more details on subjects presented in this overview.

a) Results Of Operations

Net income of $6,365,000 for the three months ended September 30, 2010 increased $1,966,000, or 44.7%, from $4,399,000 for the comparable 2009 period. Basic and diluted net income per share was $0.46 for the third quarter of 2010, an increase of 43.8% from $0.32 for the third quarter of 2009. Annualized return on average assets and annualized return on average stockholders equity were 1.35% and 15.25%, respectively, for the third quarter of 2010, compared to .99% and 11.48%, respectively, for the same period in 2009.

Net income of $16,902,000 for the nine months ended September 30, 2010 increased $3,478,000, or 25.9%, from $13,424,000 for the comparable 2009 period. Basic net income per share was $1.24 for the first nine months of 2010, compared to $0.99 for the same period of 2009. Net income per share on a diluted basis was $1.23 for the first nine months of 2010 compared to $0.98 for the same period of 2009. Annualized return on average assets and annualized return on average stockholders equity were 1.24% and 14.01%, respectively, for the first nine months of 2010, compared to 1.06% and 12.04%, respectively, for the same period in 2009.

Net Interest Income

The following tables present the average balance sheets for the three and nine month periods ended September 30, 2010 and 2009 along with the related calculation of tax-equivalent net interest income, net interest margin and net interest spread for the related periods. See the notes following the tables for further explanation.

27

Table of Contents

Average Balances and Interest Rates Taxable Equivalent Basis

	Three months ended September 30					
	2010			2009		
(Dollars in thousands)	Average Balances	Interest	Average Rate	Average Balances	Interest	Average Rate
Earning assets:						
Federal funds sold	$ 64,288	$ 41	0.25%	$ 72,759	$ 31	0.17%
Mortgage loans held for sale	7,907	97	4.87%	7,660	105	5.44%
Securities:						
Taxable	159,055	1,214	3.03%	161,981	1,332	3.26%
Tax-exempt	38,492	464	4.78%	27,123	399	5.84%
FHLB stock	5,772	57	3.92%	5,547	60	4.29%
Loans, net of unearned income	1,484,741	20,528	5.49%	1,391,207	19,561	5.58%
Total earning assets	1,760,255	22,401	5.05%	1,666,277	21,488	5.12%
Less allowance for loan losses	23,602			17,698		
	1,736,653			1,648,579		
Non-earning assets:						
Cash and due from banks	27,238			25,450		
Premises and equipment	29,974			28,548		
Accrued interest receivable and other assets	77,183			60,129		
Total assets	$ 1,871,048			$ 1,762,706		
Interest bearing liabilities:						
Deposits:						
Interest bearing demand deposits	$ 246,644	$ 116	0.19%	$ 226,987	$ 120	0.21%
Savings deposits	66,728	43	0.26%	57,033	44	0.31%
Money market deposits	468,299	936	0.79%	345,419	680	0.78%
Time deposits	430,054	2,115	1.95%	531,936	3,772	2.81%
Securities sold under agreements to repurchase	55,971	89	0.63%	50,940	76	0.59%
Fed funds purchased and other short term borrowings	27,294	14	0.20%	29,594	15	0.20%
FHLB advances	76,750	622	3.22%	90,457	917	4.02%
Long-term debt	40,900	869	8.43%	40,930	884	8.57%
Total interest bearing liabilities	1,412,640	4,804	1.35%	1,373,296	6,508	1.88%
Non-interest bearing liabilities:						
Non-interest bearing demand deposits	252,394			200,600		
Accrued interest payable and other liabilities	40,436			36,804		
Total liabilities	1,705,470			1,610,700		
Stockholders equity	165,578			152,006		
Total liabilities and stockholders equity	$ 1,871,048			$ 1,762,706		
Net interest income		$ 17,597			$ 14,980	
Net interest spread			3.70%			3.24%
Net interest margin			3.97%			3.57%

28

Table of Contents

	Nine months ended September 30	
	2010	2009