S Y BANCORP INC
Form 10-Q
August 05, 2011
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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 June 30, 2011

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 x No o

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 o	Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

The number of shares of the registrant s Common Stock, no par value, outstanding as of July 31, 2011, was 13,797,256.

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S.Y. BANCORP, INC. AND SUBSIDIARY

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PART I FINANCIAL INFORMATION

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S.Y. BANCORP, INC. AND SUBSIDIARY

Consolidated Balance Sheets

June 30, 2011 and December 31, 2010

(In thousands, except share data)

	June 30, 2011 (Unaudited)	December 31, 2010
Assets		
Cash and due from banks	$ 24,226	$ 17,702
Federal funds sold	19,972	23,953
Mortgage loans held for sale	4,439	12,387
Securities available for sale (amortized cost of $250,618 in 2011 and $240,097 in 2010)	258,280	245,332
Securities held to maturity (fair value of $22 in 2010)		20
Federal Home Loan Bank stock	4,948	4,771
Other securities	1,001	1,001
Loans	1,538,950	1,508,425
Less allowance for loan losses	27,564	25,543
Net loans	1,511,386	1,482,882
Premises and equipment, net	34,564	31,665
Bank owned life insurance	26,628	26,124
Accrued interest receivable	5,928	6,288
Other assets	52,012	50,820
Total assets	$ 1,943,384	$ 1,902,945
Liabilities and Stockholders Equity		
Deposits:		
Non-interest bearing	$ 266,745	$ 247,465
Interest bearing	1,265,626	1,246,003
Total deposits	1,532,371	1,493,468
Securities sold under agreements to repurchase	64,856	60,075
Federal funds purchased	22,928	25,436
Other short-term borrowings	1,243	1,998
Accrued interest payable	179	304
Other liabilities	41,645	50,461
Federal Home Loan Bank advances	60,437	60,442
Subordinated debentures	40,900	40,900
Total liabilities	1,764,559	1,733,084
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 13,798,914 and 13,736,942 shares in 2011 and 2010, respectively	6,885	6,679
Additional paid-in capital	13,810	12,206
Retained earnings	153,414	147,837
Accumulated other comprehensive income	4,716	3,139
Total stockholders equity	178,825	169,861
Total liabilities and stockholders equity	$ 1,943,384	$ 1,902,945

See accompanying notes to unaudited consolidated financial statements.

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S.Y. BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Income

For the three and six months ended June 30, 2011 and 2010

(In thousands, except per share data)

	For three months ended June 30, 2011	For three months ended June 30, 2010	For six months ended June 30, 2011	For six months ended June 30, 2010
Interest income:				
Loans	$ 19,875	$ 19,715	$ 39,475	$ 38,929
Federal funds sold	49	19	95	44
Mortgage loans held for sale	34	53	97	119
Securities taxable	1,260	1,376	2,492	2,780
Securities tax-exempt	348	285	695	533
Total interest income	21,566	21,448	42,854	42,405
Interest expense:				
Deposits	2,654	3,394	5,325	7,076
Fed funds purchased	10	8	23	17
Securities sold under agreements to repurchase	64	81	131	168
Federal Home Loan Bank advances	364	556	725	1,081
Subordinated debentures	863	862	1,724	1,722
Total interest expense	3,955	4,901	7,928	10,064
Net interest income	17,611	16,547	34,926	32,341
Provision for loan losses	2,600	2,384	5,400	5,079
Net interest income after provision for loan losses	15,011	14,163	29,526	27,262
Non-interest income:				
Investment management and trust services	3,661	3,232	7,198	6,493
Service charges on deposit accounts	2,034	2,187	3,958	4,185
Bankcard transaction revenue	960	863	1,837	1,614
Gains on sales of mortgage loans held for sale	441	445	823	830
Brokerage commissions and fees	530	503	1,043	959
Bank owned life insurance income	255	248	504	491
Other	271	445	794	1,327
Total non-interest income	8,152	7,923	16,157	15,899
Non-interest expenses:				
Salaries and employee benefits	8,648	8,319	17,048	16,408
Net occupancy expense	1,357	1,296	2,587	2,572
Data processing expense	1,346	1,322	2,483	2,459
Furniture and equipment expense	337	321	692	635
FDIC insurance expense	339	531	960	1,002
Other	2,698	2,592	5,782	5,063
Total non-interest expenses	14,725	14,381	29,552	28,139
Income before income taxes	8,438	7,705	16,131	15,022
Income tax expense	2,441	2,149	4,643	4,485
Net income	5,997	5,556	11,488	10,537
Net income per share:				
Basic	$ 0.43	$ 0.41	$ 0.83	$ 0.77
Diluted	$ 0.43	$ 0.40	$ 0.83	$ 0.77
Average common shares:				

Basic	13,789	13,690	13,768	13,668
Diluted	13,879	13,790	13,857	13,752

See accompanying notes to unaudited consolidated financial statements.

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S.Y. BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows

For the six months ended June 30, 2011 and 2010

(In thousands)

	2011	2010
Operating activities:		
Net income	$ 11,488	$ 10,537
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	5,400	5,079
Depreciation, amortization and accretion, net	1,917	1,653
Deferred income tax benefit	(635)	(1,184)
Gain on sales of mortgage loans held for sale	(823)	(830)
Origination of mortgage loans held for sale	(42,953)	(54,494)
Proceeds from sale of mortgage loans held for sale	51,724	61,810
Bank owned life insurance income	(504)	(491)
Decrease (increase) in value of private investment fund	102	(368)
Loss on the disposal of equipment	382	2
Loss (gain) on the sale of other real estate	32	(51)
Stock compensation expense	564	455
Excess tax benefits from share-based compensation arrangements	(77)	(48)
Decrease (increase) in accrued interest receivable and other assets	951	(7,804)
Increase (decrease) in accrued interest payable and other liabilities	(8,864)	11,257
Net cash provided by operating activities	18,704	25,523
Investing activities:		
Purchases of securities available for sale	(132,819)	(91,798)
Proceeds from sale of securities available for sale		
Proceeds from maturities of securities available for sale	121,840	110,259
Proceeds from maturities of securities held to maturity	20	10
Net increase in loans	(41,503)	(63,540)
Purchases of premises and equipment	(4,750)	(1,353)
Proceeds from disposal of premises and equipment	7	3
Proceeds from sale of foreclosed assets	5,293	887
Net cash used in investing activities	(51,912)	(45,532)
Financing activities:		
Net increase in deposits	38,903	55,647
Net increase in securities sold under agreements to repurchase and federal funds purchased	2,273	1,357
Net decrease in other short-term borrowings	(755)	(326)
Proceeds from Federal Home Loan Bank advances		10,000
Repayments of Federal Home Loan Bank advances	(5)	(5)
Repayments of subordinated debentures		(30)
Issuance of common stock for options and dividend reinvestment plan	381	442
Excess tax benefits from share-based compensation arrangements	77	48
Common stock repurchases	(167)	(79)
Cash dividends paid	(4,956)	(4,649)
Net cash provided by financing activities	35,751	62,405
Net increase in cash and cash equivalents	2,543	42,396
Cash and cash equivalents at beginning of period	41,655	32,424
Cash and cash equivalents at end of period	$ 44,198	$ 74,820
Supplemental cash flow information:		

Income tax payments	$	985	$	4,080
Cash paid for interest		8,053		10,036
Supplemental non-cash activity:				
Transfers from loans to other real estate owned	$	7,599	$	1,364

See accompanying notes to unaudited consolidated financial statements.

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S.Y. BANCORP, INC. AND SUBSIDIARY

Consolidated Statement of Changes in Stockholders Equity

For the six months ended June 30, 2011

(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, 2010	13,737	$ 6,679	$ 12,206	$ 147,837	$ 3,139	$ 169,861
Net income				11,488		11,488
Change in accumulated other comprehensive income, net of tax					1,577	1,577
Stock compensation expense			564			564
Stock issued for stock options exercised and dividend reinvestment plan	46	154	710			864
Stock issued for non-vested restricted stock	42	140	866	(1,006)		
Cash dividends, $0.36 per share				(4,956)		(4,956)
Shares repurchased or cancelled	(26)	(88)	(536)	51		(573)
Balance June 30, 2011	13,799	$ 6,885	$ 13,810	$ 153,414	$ 4,716	$ 178,825

See accompanying notes to unaudited consolidated financial statements.

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S.Y. BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Comprehensive Income

For the three and six months ended June 30, 2011 and 2010

(In thousands)

	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Net income	$ 5,997	$ 5,556	$ 11,488	$ 10,537
Other comprehensive income, net of tax:				
Unrealized gains on securities available for sale:				
Unrealized gains arising during the period (net of tax of $775, $598, $849 and $908, respectively)	1,440	1,110	1,577	1,687
Other comprehensive income	1,440	1,110	1,577	1,687
Comprehensive income	$ 7,437	$ 6,666	$ 13,065	$ 12,224

See accompanying notes to unaudited consolidated financial statements.

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S.Y. BANCORP, INC. AND SUBSIDIARY

(1) Summary of Significant Accounting Policies

The accompanying 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, 2010 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 six month periods ended June 30, 2011 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.

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(2) Securities

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

June 30, 2011 **Securities available for sale** **(in thousands)**	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
U.S. Treasury and other U.S. government obligations	$ 23,000	$	$	$ 23,000
Government sponsored enterprise obligations	100,808	2,948		103,756
Mortgage-backed securities	58,936	2,801	35	61,702
Obligations of states and political subdivisions	66,624	1,953	25	68,552
Trust preferred securities of other financial institutions	1,250	20		1,270
Total securities available for sale	$ 250,618	$ 7,722	$ 60	$ 258,280

December 31, 2010 **Securities available for sale** **(in thousands)**	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
Government sponsored enterprise obligations	$ 111,802	$ 2,737	$	$ 114,539
Mortgage-backed securities	58,616	2,348	216	60,748
Obligations of states and political subdivisions	68,429	777	417	68,789
Trust preferred securities of other financial institutions	1,250	6		1,256
Total securities available for sale	$ 240,097	$ 5,868	$ 633	$ 245,332

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.

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At December 31, 2010, Bancorp had mortgage-backed securities classified as held to maturity. These securities, with an amortized cost of $20,000, had a fair value of $22,000. There are no securities held to maturity as of June 30, 2011.

In addition to the available for sale portfolio, investment securities held by Bancorp include certain securities which are not readily marketable and are carried at cost. This category includes holdings of Federal Home Loan Bank of Cincinnati (FHLB) stock which are required as part of the condition for borrowing availability from the FHLB and are classified as restricted securities. See Note 5 for information relating to FHLB borrowings. 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.

A summary of securities as of June 30, 2011 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.

	Securities Available for Sale	
(In thousands)	**Cost**	**Fair Value**
Due within one year	$ 67,308	$ 67,354
Due within one year through five years	87,624	90,217
Due within five years through ten years	38,034	40,153
Due after ten years	57,652	60,556
	$ 250,618	$ 258,280

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Securities with unrealized losses not recognized in income at June 30, 2011 and December 31, 2010 are as follows:

	Less than 12 months		12 months or more		Total	
(In thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2011						
Mortgage-backed securities	$ 4,881	$ 35	$	$	$ 4,881	$ 35
Obligations of states and political subdivisions	2,186	25			2,186	25
Total temporarily impaired securities	$ 7,067	$ 60	$	$	$ 7,067	$ 60
December 31, 2010						
Mortgage-backed securities	$ 9,620	$ 216	$	$	$ 9,620	$ 216
Obligations of states and political subdivisions	31,444	417			31,444	417
Total temporarily impaired securities	$ 41,064	$ 633	$	$	$ 41,064	$ 633

Unrealized losses on Bancorp s investment securities portfolio have not been recognized in income because the securities are of high credit quality, and the decline in fair values is largely due to changes in the prevailing interest rate environment since the purchase date. The fair value is expected to recover as the securities reach their maturity date and/or the interest rate environment returns to conditions similar to when the securities were purchased. These investments consist of 5 and 49 separate investment positions as of June 30, 2011 and December 31, 2010, respectively, that are not considered other-than-temporarily impaired. Based on this information, Bancorp has not recorded other-than-temporary losses on any securities held at June 30, 2011.

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. As of June 30, 2011, Bancorp had no securities which had been impaired for 12 months or longer. As of June 30, 2011, 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 $1,014,000, and an unrealized gain of $14,000. Because 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, management is of the opinion that none of the securities are other-than-temporarily impaired at June 30, 2011.

(3) Stock-Based Compensation

The fair value of all new and modified awards granted, net of estimated forfeitures, is recognized as compensation expense over the respective service period. 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. In 2010, shareholders approved a proposal to amend the 2005 Stock Incentive Plan to reserve an additional 700,000

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shares of common stock for issuance under the plan. As of June 30, 2011, there were 668,820 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, equity grants to certain executive officers vested six months after grant date. Restricted shares generally vest over three to five years. All awards under both plans have been granted at an exercise price equal to the market value of common stock at the time of grant; options and SARs expire ten years after the grant date.

In April 2011, the Board of Directors of Bancorp approved an amendment to the 2005 Stock Incentive Plan to authorize restricted stock units (RSUs) as a type of award that the Company may grant pursuant to the Plan. The RSU awards entitle those officers to issuance of one share of common stock for each vested RSU shortly after expiration of a three-year performance period, provided certain goals are achieved. Executives do not have voting rights and do not receive dividends or other distributions paid on stock related to RSUs, until that stock is actually issued.

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

	For three months ended June 30,		For six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Stock-based compensation expense before income taxes	$ 316,000	$ 247,000	$ 564,000	$ 455,000
Deferred tax benefit	110,000	86,000	197,000	159,000
Reduction of net income	$ 206,000	$ 161,000	$ 367,000	$ 296,000

Bancorp expects to record an additional $662,000 of stock-based compensation expense in 2011 for equity grants outstanding as of June 30, 2011. As of June 30, 2011, Bancorp has $3,503,000 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 $369,000 and $429,000 from the exercise of options during the first six months of 2011 and 2010, 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 fair value of restricted stock units is determined by Bancorp s closing stock price on the date of the award, less the present value of dividends expected to be paid during the performance period.

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The following assumptions were used in SAR/option valuations at the grant date in each year:

	2011	2010
Dividend yield	2.48%	2.18%
Expected volatility	22.64	23.87
Risk free interest rate	2.90	3.57
Forfeitures	6.07	5.96
Expected life of options and SARs (in years)	7.5	7.6

The dividend yield and expected volatility are based on historical information corresponding to the expected life of options and SARs 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 options.

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

A summary of stock option and SARs activity and related information for the six months ended June 30, 2011 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	Weighted Average Remaining Contractual Life
At December 31, 2010						
Vested and exercisable	710	$ 16.00-26.83	$ 22.03	$ 2,007	$ 4.91	4.15
Unvested	273	21.03-26.83	22.85	552	5.36	7.72
Total outstanding	983	16.00-26.83	22.26	2,559	5.03	5.14
Granted	67	23.76-24.87	23.78		5.04	
Exercised	(46)	16.00-22.81	16.93	323	3.47	
Forfeited	(9)	18.05-26.83	21.54	18	4.85	
At June 30, 2011						
Vested and exercisable	755	16.00-26.83	22.55	1,090	5.07	4.10
Unvested	240	21.03-26.83	22.82	211	5.22	8.20
Total outstanding	995	16.00-26.83	22.61	$ 1,301	5.11	5.09
Vested during year	95	21.03-26.83	23.59	$ 59	5.48	

Intrinsic value for stock options is defined as the amount by which the current market price of the underlying stock exceeds the exercise price.

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In the first quarter of 2011, Bancorp granted 66,579 SARs at the weighted average current market price of $23.78 and a Black-Scholes fair value of $5.04. There were no SARs granted in the second quarter. In the first six months of 2011, Bancorp granted 41,991 shares of restricted common stock at the weighted average current market price of $23.96. Also in the second quarter of 2011, Bancorp awarded RSUs with a fair value of $21.99 to executive officers of the Bank, the three-year performance period for which began January 1, 2011. Bancorp believes, based on most recent analysis, the most likely vesting of these RSUs will be 20,228 shares of common stock.

(4) Loans

The composition of loans by primary loan classification follows:

(In thousands)		**June 30, 2011**		**December 31, 2010**
Commercial and industrial	$	365,008	$	343,956
Real estate mortgage:				
Commercial investment		382,753		362,904
Owner occupied commercial		313,531		316,291
1-4 family residential		159,320		157,983
Home equity - first lien		38,376		39,449
Home equity - junior lien		83,880		91,813
Subtotal: Real estate mortgage		977,860		968,440
Construction and development		158,412		159,482
Consumer		37,670		36,547
Total loans	$	1,538,950	$	1,508,425

An analysis of the changes in the allowance for loan losses for the six months ended June 30, 2011 and 2010 follows (in thousands):

		2011		**2010**
Beginning balance January 1,	$	25,543	$	20,000
Provision for loan losses		5,400		5,079
Loans charged off		(3,715)		(2,560)
Recoveries		336		414
Ending balance June 30,	$	27,564	$	22,933

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The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of June 30, 2011 and December 31, 2010.

June 30, 2011 (in thousands)	Type of Loan Commercial and industrial	Construction and development	Real estate mortgage	Consumer	Unallocated	Total
Allowance for credit losses						
Beginning balance December 31, 2010	$ 2,796	$ 3,630	$ 12,272	$ 623	$ 6,222	$ 25,543
Charge-offs	(816)	(1,226)	(1,366)	(307)		(3,715)
Recoveries	20		116	200		336
Provision	3,390	989	2,613	60	(1,652)	5,400
Ending balance June 30, 2011	$ 5,390	$ 3,393	$ 13,635	$ 576	$ 4,570	$ 27,564
Balance: individually evaluated for impairment	$ 500	$	$ 824	$		$ 1,324
Balance: collectively evaluated for impairment	$ 4,890	$ 3,393	$ 12,811	$ 576	$ 4,570	$ 26,240
Balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$
Loans						
Balance	$ 365,008	$ 158,412	$ 977,860	$ 37,670		$ 1,538,950
Balance: individually evaluated for impairment	$ 2,209	$ 700	$ 12,815	$ 96		$ 15,820
Balance: collectively evaluated for impairment	$ 362,799	$ 157,712	$ 965,045	$ 37,574		$ 1,523,130
Balance: loans acquired with deteriorated credit quality	$	$	$	$		$

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December 31, 2010 (in thousands)	Type of Loan: Commercial and industrial	Construction and development	Real estate mortgage	Consumer	Unallocated	Total
Allowance for credit losses						
Beginning balance December 31, 2009	$ 4,091	$ 1,518	$ 6,513	$ 947	$ 6,931	$ 20,000
Charge-offs	(1,418)	(2,211)	(2,450)	(687)		(6,766)
Recoveries	115	26	163	536		840
Provision	8	2,947	8,046	(173)	641	11,469
Ending balance December 31, 2010	$ 2,796	$ 2,280	$ 12,272	$ 623	$ 7,572	$ 25,543
Balance: individually evaluated for impairment	$ 90	$	$ 1,724	$		$ 1,814
Balance: collectively evaluated for impairment	$ 2,706	$ 2,280	$ 10,548	$ 623	$ 7,572	$ 23,729
Balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$
Loans						
Balance	$ 343,956	$ 159,482	$ 968,440	$ 36,547		$ 1,508,425
Balance: individually evaluated for impairment	$ 520	$ 700	$ 15,955	$ 95		$ 17,270
Balance: collectively evaluated for impairment	$ 343,436	$ 158,782	$ 952,485	$ 36,452		$ 1,491,155
Balance: loans acquired with deteriorated credit quality	$	$	$	$		$

Information regarding impaired loans follows (in thousands):

	June 30, 2011	December 31, 2010
Principal balance of impaired loans	$ 15,820	$ 17,270
Impaired loans with a valuation allowance	3,832	7,335
Amount of valuation allowance	1,324	1,814
Impaired loans with no valuation allowance	11,988	9,935
Average balance of impaired loans for the period	15,572	13,212

Management uses the following classes of loans when assessing and monitoring the risk and performance of the loan portfolio:

- Commercial and industrial
- Real estate mortgage
- Construction and development
- Consumer

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The following table presents loans individually evaluated for impairment as of June 30, 2011 and December 31, 2010.

June 30, 2011 (in thousands)	**Recorded investment**	**Unpaid principal balance**	**Related allowance**
Loans with no related allowance recorded			
Commercial and industrial	$ 794	$ 1,918	
Real estate mortgage	10,398	11,653	
Construction and development	700	700	
Consumer	96	139	
Loans with an allowance recorded			
Commercial and industrial	$ 1,415	$ 2,000	$ 500
Real estate mortgage	2,417	2,417	824
Construction and development			
Consumer			
Total			
Commercial and industrial	$ 2,209	$ 3,918	$ 500
Real estate mortgage	$ 12,815	$ 14,070	$ 824
Construction and development	$ 700	$ 700	$
Consumer	$ 96	$ 139	$

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December 31, 2010 (in thousands)		**Recorded investment**		**Unpaid principal balance**		**Related allowance**
Loans with no related allowance recorded						
Commercial and industrial	$	420	$	1,982		
Real estate mortgage		8,720		9,455		
Construction and development		700		700		
Consumer		95		140		
Subtotal		9,935		12,277		
Loans with an allowance recorded						
Commercial and industrial	$	100	$	292	$	90
Real estate mortgage		7,235		7,235		1,724
Construction and development						
Consumer						
Subtotal		7,335		7,527		1,814
Total						
Commercial and industrial	$	520	$	2,274	$	90
Real estate mortgage	$	15,955	$	16,690	$	1,724
Construction and development	$	700	$	700	$	
Consumer	$	95	$	140	$	
Subtotal		17,270		19,804		1,814

Unpaid principal balance does not reflect partial charge-offs which may have occurred over the life of the loans.

Impaired loans include non-accrual loans and loans accounted for as troubled debt restructuring. Non-performing loans include the balance of impaired loans plus any loans over 90 days past due and still accruing interest.

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The following table presents the recorded investment in non-accrual loans as of June 30, 2011 and December 31, 2010.

(In thousands)	June 30 2011	December 31 2010
Commercial and industrial	$ 2,286	$ 2,328
Construction and development	3,288	4,589
Real estate mortgage	9,899	7,194
Consumer	97	277
Total	$ 15,570	$ 14,388

Included in non-performing loans are loans accounted for as troubled debt restructuring totaling $250,000 at June 30, 2011 and $2,882,000 at December 31, 2010, which continue to accrue interest.

The following table presents the aging of the recorded investment in past due loans as of June 30, 2011 and December 31, 2010.

June 30, 2011 (in thousands)	30-59 days past due	60-89 days past due	Greater than 90 days past due	Total past due	Current	Total loans	Recorded investment > 90 days and accruing
Commercial and industrial	$ 1,006	$ 92	$ 2,209	$ 3,307	$ 361,701	$ 365,008	$
Real estate mortgage	4,815	5,650	14,228	24,693	953,167	977,860	1,663
Construction and development	699	2,318	700	3,717	154,695	158,412	
Consumer	222	7	96	325	37,345	37,670	
Total	$ 6,742	$ 8,067	$ 17,233	$ 32,042	$ 1,506,908	$ 1,538,950	$ 1,663

December 31, 2010 (in thousands)	30-59 days past due	60-89 days past due	Greater than 90 days past due	Total past due	Current	Total loans	Recorded investment > 90 days and accruing
Commercial and industrial	$ 1,681	$ 194	$ 547	$ 2,422	$ 341,534	$ 343,956	$ 27
Real estate mortgage	5,943	4,821	15,039	25,803	942,637	968,440	1,966
Construction and development	256		700	956	158,526	159,482	
Consumer	69	4	146	219	36,328	36,547	51
Total	$ 7,949	$ 5,019	$ 16,432	$ 29,400	$ 1,479,025	$ 1,508,425	$ 2,044

Bancorp categorizes loans into credit risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends. Pass-rated loans included all risk-rated loans other than those classified as special mention, substandard, and doubtful, which are defined below:

- Special Mention: Loans classified as special mention have a potential weakness that deserves management s close attention. If left uncorrected, these potential weaknesses may result in

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deterioration of repayment prospects for the loan or of the Bank s credit position at some future date.

- Substandard: Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize repayment of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

- Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or repayment in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

As of June 30, 2011 and December 31, 2010, the risk categories of loans were as follows:

Credit risk profile by internally assigned grade

(in thousands)

June 30, 2011	**Commercial and industrial**	**Real estate mortgage**	**Construction and development**	**Consumer**	**Total**
Grade					
Pass	$ 328,320	$ 899,500	$ 142,670	$ 37,632	$ 1,408,122
Special mention	18,756	34,296	6,258	14	59,324
Substandard	17,932	44,064	9,484	24	71,504
Doubtful					
Total	$ 365,008	$ 977,860	$ 158,412	$ 37,670	$ 1,538,950

December 31, 2010	**Commercial and industrial**	**Real estate mortgage**	**Construction and development**	**Consumer**	**Total**
Grade					
Pass	$ 315,053	$ 891,762	$ 140,986	$ 36,172	$ 1,383,973
Special mention	20,440	30,402	6,222	67	57,131
Substandard	8,463	46,276	12,274	308	67,321
Doubtful					
Total	$ 343,956	$ 968,440	$ 159,482	$ 36,547	$ 1,508,425

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Credit risk profile based on payment activity

(in thousands)

June 30, 2011	Commercial and industrial	Real estate mortgage	Construction and development	Consumer	Total
Performing	$ 362,799	$ 963,382	$ 157,712	$ 37,574	$ 1,521,467
Non-performing	2,209	14,478	700	96	17,483
Total	$ 365,008	$ 977,860	$ 158,412	$ 37,670	$ 1,538,950

December 31, 2010	Commercial and industrial	Real estate mortgage	Construction and development	Consumer	Total
Performing	$ 343,409	$ 950,519	$ 158,782	$ 36,401	$ 1,489,111
Non-performing	547	17,921	700	146	19,314
Total	$ 343,956	$ 968,440	$ 159,482	$ 36,547	$ 1,508,425

(5) Federal Home Loan Bank Advances

The Bank had outstanding borrowings of $60,437,000 at June 30, 2011, via six separate advances. For five advances totaling $60 million, all of which are non-callable, interest payments are due monthly, with principal due at maturity. The sixth advance totals $437,000, and principal and interest payments are due monthly based on a 15 year amortization schedule. In the fourth quarter of 2010, Bancorp restructured and extended terms on two advances with FHLB resulting in lower interest cost over the remaining term of these advances. Prepayment penalties totaling $1,336,000 were incurred. In accordance with US GAAP, prepayment penalties associated with the modification of advances are to be amortized over the life of the new advances as interest expense, resulting in effective interest rates greater than the contractual rate paid to FHLB. The following is a summary of the contractual maturities and average effective rates as of June 30, 2011:

(In thousands)	Advance	Rate
2013	$ 20,000	1.55%
2014	20,000	2.43%
2015	20,000	3.34%
2024	437	2.40%
	$ 60,437	2.44%

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 Federal Home Loan Bank of Cincinnati (FHLB) enables the Bank to borrow up to an additional $184.5 million as of June 30, 2011 under terms to be established at the time of the advance. The Bank also has a standby letter of credit from the FHLB for $17.8 million outstanding at

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June 30, 2011. 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 above the $250,000 per account protection provided by the FDIC to be backed by some form of collateral. The standby letter of credit from the FHLB collateralizes 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 not be amortized, but instead 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 June 30, 2011 and December 31 2010 were $2,327,000 and $2,188,000, respectively. The total outstanding principal balances of loans serviced for others were $272,585,000 and $254,988,000 at June 30, 2011, and December 31, 2010 respectively. Changes in the net carrying amount of MSRs for the six months ended June 30, 2011 and 2010 are shown in the following table.

(in thousands)	**2011**	**2010**
Balance at beginning of period	$ 1,785	$ 1,616
Originations	224	257
Amortization	(346)	(236)
Balance at June 30	$ 1,663	$ 1,637

(7) Defined Benefit Retirement Plan

The Bank sponsors an unfunded, non-qualified, defined benefit retirement plan for certain key officers with no plan to add additional participants. 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 net periodic benefits costs, which include interest cost and amortization of net losses, totaled $31,000 for the three months ended June 30, 2011 and 2010. For the six months ended June 30, 2011 and 2010, the net periodic benefit costs totaled $62,000.

(8) Commitments and Contingent Liabilities

As of June 30, 2011, 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 $335,625,000 including standby letters of credit of $10,318,000 represent normal banking transactions, and no significant losses are anticipated to result from these commitments as of June 30, 2011. Commitments to extend credit were $350,314,000, including letters of credit of $9,598,000, as of December 31, 2010. Bancorp s maximum 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-

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balance sheet instruments. 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, equipment, and real estate.

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 one to two 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 20 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 June 30, 2011, Bancorp would have been required to make payments of approximately $2,811,000. 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

Bancorp has a class of preferred stock (no par value; 1,000,000 shares authorized),the relative rights, preferences and other terms of which or any series within the class will be determined by the Board of Directors prior to any issuance. Some of this preferred stock would 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 June 30, 2011.

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(10) Net Income Per Share

The following table reflects, for the three and six months ended June 30, 2011 and 2010, net income (the numerator) and average shares outstanding (the denominator) for the basic and diluted net income per share computations:

	Three months ended June 30		Six months ended June 30	
(In thousands, except per share data)	**2011**	**2010**	**2011**	**2010**
Net income, basic and diluted	$ 5,997	$ 5,556	$ 11,488	$ 10,537
Average shares outstanding	13,789	13,690	13,768	13,668
Effect of dilutive securities	90	100	89	84
Average shares outstanding including dilutive securities	13,879	13,790	13,857	13,752
Net income per share, basic	$ 0.43	$ 0.41	$ 0.83	$ 0.77
Net income per share, diluted	$ 0.43	$ 0.40	$ 0.83	$ 0.77

(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.

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Selected financial information by business segment for the three and six month periods ended June 30, 2011 and 2010 follows:

(In thousands)	Three months ended June 30 2011	2010	Six Months ended June 30 2011	2010
Net interest income				
Commercial banking	$ 17,581	$ 16,520	$ 34,863	$ 32,284
Investment management and trust	30	27	63	57
Total	$ 17,611	$ 16,547	$ 34,926	$ 32,341
Provision for loan losses:				
Commercial banking	$ 2,600	$ 2,384	$ 5,400	$ 5,079
Investment management and trust				
Total	$ 2,600	$ 2,384	$ 5,400	$ 5,079
Non-interest income:				
Commercial banking	$ 4,491	$ 4,691	$ 8,959	$ 9,406
Investment management and trust	3,661	3,232	7,198	6,493
Total	$ 8,152	$ 7,923	$ 16,157	$ 15,899
Non-interest expense:				
Commercial banking	$ 12,667	$ 12,456	$ 25,698	$ 24,396
Investment management and trust	2,058	1,925	3,854	3,743
Total	$ 14,725	$ 14,381	$ 29,552	$ 28,139
Tax expense				
Commercial banking	$ 1,869	$ 1,682	$ 3,450	$ 3,503
Investment management and trust	572	467	1,193	982
Total	$ 2,441	$ 2,149	$ 4,643	$ 4,485
Net income:				
Commercial banking	$ 4,936	$ 4,689	$ 9,274	$ 8,712
Investment management and trust	1,061	867	2,214	1,825
Total	$ 5,997	$ 5,556	$ 11,488	$ 10,537

(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 June 30, 2011 and December 31, 2010 the gross amount of unrecognized tax benefits was $308,000 and $230,000, respectively. At June 30, 2011, if recognized, $284,000 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.

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Bancorp s policy is to report interest and penalties, if any, related to unrecognized tax benefits in income tax expense. As of June 30, 2011 and December 31, 2010, 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 benefit 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 first six months of 2011 were offsetting and therefore had no effect on Bancorp s earnings or cash flows.

At June 30, 2011, 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. 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 June 30, 2011 and December 31, 2010, Bancorp had outstanding interest rate swap contracts as follows:

	Receiving		Paying	
(dollar amounts in thousands)	**June 30, 2011**	**December 31, 2010**	**June 30, 2011**	**December 31, 2010**
Notional amount	$ 5,070	$ 5,270	$ 5,070	$ 5,270
Weighted average maturity (years)	7.7	8.1	7.7	8.1
Fair value	$ (319)	$ (305)	$ 319	$ 305

(14) Fair Value Measurements

Bancorp follows 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. 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.

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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 and derivative instruments 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 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 2011.

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

	Fair Value at June 30, 2011			
(In thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**
Assets				
Investment securities available for sale				
U.S. Treasury and other U.S. government obligations	$ 23,000	$	$ 23,000	$
Government sponsored enterprise obligations	103,756		103,756	
Mortgage-backed securities	61,702		61,702	
Obligations of states and political subdivisions	68,552		68,552	
Trust preferred securities of financial institutions	1,270	1,270		
Total investment securities available for sale	258,280	1,270	257,010	
Interest rate swap	319		319	
Total Assets	$ 258,599	$ 1,270	$ 257,329	$
Liabilities				
Interest rate swap	$ 319	$	$ 319	$

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(In thousands)	Total	Fair value at December 31, 2010 Level 1	Level 2	Level 3
Assets				
Investment securities available for sale				
Government sponsored enterprise obligations	$ 114,539	$	$ 114,539	$
Mortgage-backed securities	60,748		60,748	
Obligations of states and political subdivisions	68,789		68,789	
Trust preferred securities of financial institutions	1,256	1,256		
Total investment securities available for sale	245,332	1,256	244,076	
Interest rate swap	305		305	
Total Assets	$ 245,637	$ 1,256	$ 244,381	$
Liabilities				
Interest rate swap	$ 305	$	$ 305	$

Mortgage loans held for sale are recorded 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 either table below for June 30, 2011 or December 31, 2010.

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 June 30, 2011 and December 31, 2010 there was no valuation allowance for the mortgage servicing rights, as the fair value exceeded the cost. Accordingly, the MSRs are not included in either table below for June 30, 2011 or December 31, 2010.

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 June 30, 2011 and December 31, 2010, the carrying value of other real estate owned was $7,187,000 and $5,445,000, respectively. Other real estate owned is not included in either table below, as the fair value of the properties exceeded their carrying value at June 30, 2011 and December 31, 2010.

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For impaired loans in the table below, the fair value is calculated as the carrying value of only loans with a specific valuation allowance, less the specific allowance. As of June 30, 2011, total impaired loans with a valuation allowance were $3.8 million, and the specific allowance totaled $1.3 million, resulting in a fair value of $2.5 million. The losses represent the change in the specific allowances for the period indicated. See Note 4 for more information on impaired loans and allowances.

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

(in thousands)		Total	Fair value at June 30, 2011 Level 1	Level 2		Level 3		Losses for 6 month period ended June 30, 2011
Impaired loans	$	2,508	$	$	$	2,508	$	(469)

(in thousands)		Total	Fair value at December 31, 2010 Level 1	Level 2		Level 3		Losses for 6 month period ended June 30, 2010
Impaired loans	$	5,521	$	$	$	5,521	$	(755)

(15) Fair Value of Financial Instruments

The estimated fair values of financial instruments are as follows:

	June 30, 2011				December 31, 2010			
(In thousands)		Carrying Amount		Fair Value		Carrying Amount		Fair Value
Financial assets								
Cash and short-term investments	$	44,198	$	44,198	$	41,655	$	41,655
Mortgage loans held for sale		4,439		4,477		12,387		12,626
Securities		258,280		258,280		245,352		245,354
Federal Home Loan Bank stock and other securities		5,949		5,949		5,772		5,772
Loans, net		1,511,386		1,531,700		1,482,882		1,507,079
Accrued interest receivable		5,928		5,928		6,288		6,288
Interest rate swap		319		319		305		305
Financial liabilities								
Deposits	$	1,532,371						