S Y BANCORP INC
Form 10-Q
August 07, 2009
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 June 30, 2009

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 (State or other jurisdiction of incorporation or organization)	**61-1137529** (I.R.S. Employer 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 o

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 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 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

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

Common Stock, no par value 13,579,968

Shares issued and outstanding at July 30, 2009

Table of Contents

S.Y. BANCORP, INC. AND SUBSIDIARY

Index

Table of Contents

S.Y. BANCORP, INC. AND SUBSIDIARY

Unaudited Condensed Consolidated Balance Sheets

June 30, 2009 and December 31, 2008

(In thousands, except share data)

	(Unaudited) June 30 2009	December 31, 2008
Assets		
Cash and due from banks	$ 27,559	$ 24,859
Federal funds sold	6,200	2,254
Mortgage loans held for sale	15,459	2,950
Securities available for sale (amortized cost of $220,592 in 2009 and $169,505 in 2008)	223,169	173,371
Securities held to maturity (fair value of $41 in 2009 and $44 in 2008)	39	43
Federal Home Loan Bank stock and other securities	5,547	4,324
Loans	1,398,679	1,349,637
Less allowance for loan losses	17,077	15,381
Net loans	1,381,602	1,334,256
Premises and equipment, net	27,402	27,926
Bank owned life insurance	24,629	24,142
Accrued interest receivable	5,715	5,955
Other assets	29,438	28,683
Total assets	$ 1,746,759	$ 1,628,763
Liabilities and Stockholders Equity		
Deposits:		
Non-interest bearing	$ 205,403	$ 182,778
Interest bearing	1,131,610	1,088,147
Total deposits	1,337,013	1,270,925
Securities sold under agreements to repurchase and federal funds purchased	92,116	66,517
Other short-term borrowings	1,717	1,132
Accrued interest payable	582	690
Other liabilities	34,419	34,039
Federal Home Loan Bank advances	90,458	70,000
Subordinated debentures	40,930	40,960
Total liabilities	1,597,235	1,484,263
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 13,580,317 and 13,473,740 shares in 2009 and 2008, respectively	6,157	5,802
Additional paid-in capital	9,133	7,485
Retained earnings	132,782	128,923
Accumulated other comprehensive income	1,452	2,290
Total stockholders equity	149,524	144,500
Total liabilities and stockholders equity	$ 1,746,759	$ 1,628,763

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 six months ended June 30, 2009 and 2008

(In thousands, except per share data)

	For three months ended June 30, 2009	For three months ended June 30, 2008	For six months ended June 30, 2009	For six months ended June 30, 2008
Interest income:				
Loans	$ 19,204	$ 20,050	$ 37,947	$ 40,382
Federal funds sold	17	84	20	139
Mortgage loans held for sale	105	87	181	148
Securities taxable	1,187	1,010	2,608	2,202
Securities tax-exempt	284	246	558	484
Total interest income	20,797	21,477	41,314	43,355
Interest expense:				
Deposits	4,664	5,635	9,337	12,661
Securities sold under agreements to repurchase and federal funds purchased	65	276	146	730
Other short-term borrowings		117		227
Federal Home Loan Bank advances	868	1,033	1,648	2,059
Subordinated debentures	883	1	1,758	2
Total interest expense	6,480	7,062	12,889	15,679
Net interest income	14,317	14,415	28,425	27,676
Provision for loan losses	2,200	975	3,825	2,200
Net interest income after provision for loan losses	12,117	13,440	24,600	25,476
Non-interest income:				
Investment management and trust services	2,801	3,238	5,472	6,517
Service charges on deposit accounts	2,038	2,117	3,849	4,109
Bankcard transaction revenue	747	691	1,406	1,312
Gains on sales of mortgage loans held for sale	444	319	943	755
Brokerage commissions and fees	437	442	822	883
Bank owned life insurance income	245	258	488	510
Other	1,352	592	1,645	1,048
Total non-interest income	8,064	7,657	14,625	15,134
Non-interest expenses:				
Salaries and employee benefits	7,629	7,326	14,989	14,633
Net occupancy expense	1,013	1,036	2,021	2,045
Data processing expense	1,002	896	1,808	1,648
Furniture and equipment expense	307	276	599	552
State bank taxes	474	314	862	654
FDIC insurance expense	1,245	90	1,667	264
Other	2,360	2,394	4,353	4,606
Total non-interest expenses	14,030	12,332	26,299	24,402
Income before income taxes	6,151	8,765	12,926	16,208
Income tax expense	1,863	2,636	3,901	5,041
Net income	$ 4,288	$ 6,129	$ 9,025	$ 11,167
Net income per share:				
Basic	$ 0.32	$ 0.46	$ 0.67	$ 0.83

Diluted	0.31	0.45	0.66	0.82
Average common shares:				
Basic	13,564	13,409	13,532	13,431
Diluted	13,729	13,584	13,683	13,598

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 six months ended June 30, 2009 and 2008

(In thousands)

	2009	2008
Operating activities:		
Net income	$ 9,025	$ 11,167
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	3,825	2,200
Depreciation, amortization and accretion, net	1,009	1,248
Deferred income tax benefit	(848)	(485)
Gain on sales of mortgage loans held for sale	(943)	(755)
Origination of mortgage loans held for sale	(139,441)	(57,346)
Proceeds from sale of mortgage loans held for sale	127,875	57,320
Bank owned life insurance income	(488)	(510)
Increase in value of private investment fund	(142)	
Gain (loss) on the sale of other real estate	2	(2)
Stock compensation expense	328	363
Excess tax benefits from share-based compensation arrangements	(98)	(1)
Reversal of valuation of mortgage servicing rights	(176)	
Decrease (increase) in accrued interest receivable and other assets	1,081	(1,138)
Increase in accrued interest payable and other liabilities	351	4,486
Net cash provided by operating activities	1,360	16,547
Investing activities:		
Purchases of securities available for sale	(116,082)	(42,614)
Proceeds from maturities of securities available for sale	64,032	92,129
Proceeds from maturities of securities held to maturity	4	786
Net increase in loans	(51,231)	(120,171)
Purchases of premises and equipment	(723)	(2,456)
Proceeds from sale of other real estate	58	1,338
Net cash used in investing activities	(103,942)	(70,988)
Financing activities:		
Net increase in deposits	66,088	156,625
Net increase (decrease) in securities sold under agreements to repurchase and federal funds purchased	25,599	(52,930)
Net increase in other short-term borrowings	585	4,052
Proceeds from Federal Home Loan Bank advances	20,460	
Repayments of Federal Home Loan Bank advances	(2)	
Repayments of subordinated debentures	(30)	(30)
Issuance of common stock for options and dividend reinvestment plan	1,315	422
Excess tax benefits from share-based compensation arrangements	98	1
Common stock repurchases	(296)	(5,272)
Cash dividends paid	(4,589)	(4,486)
Net cash provided by financing activities	109,228	98,382
Net increase in cash and cash equivalents	6,646	43,941
Cash and cash equivalents at beginning of period	27,113	39,329
Cash and cash equivalents at end of period	$ 33,759	$ 83,270

Supplemental cash flow information:				
Income tax payments	$	4,495	$	4,200
Cash paid for interest		12,995		15,855
Supplemental non-cash activity:				
Transfers from loans to other real estate owned	$	60	$	406

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 six months ended June 30, 2009

(In thousands, except per share data)

	Common stock Number of shares	Common stock Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance December 31, 2008	13,474	$ 5,802	$ 7,485	$ 128,923	$ 2,290	$ 144,500
Net income				9,025		9,025
Change in accumulated other comprehensive loss, net of tax					(838)	(838)
Stock compensation expense			328			328
Stock issued for stock options exercised and dividend reinvestment plan	93	311	1,102			1,413
Stock issued for non-vested restricted stock	25	85	481	(566)		
Cash dividends, $0.34 per share				(4,608)		(4,608)
Shares repurchased or cancelled	(12)	(41)	(263)	8		(296)
Balance June 30, 2009	13,580	$ 6,157	$ 9,133	$ 132,782	$ 1,452	$ 149,524

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 six months ended June 30, 2009 and 2008

(In thousands)

	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
Net income	$ 4,288	$ 6,129	$ 9,025	$ 11,167
Other comprehensive income (loss), net of tax:				
Unrealized losses on securities available for sale:				
Unrealized gains losses arising during the period (net of tax of ($58), (558), ($451) and ($159), respectively)	(108)	(1,036)	(838)	(296)
Other comprehensive income	(108)	(1,036)	(838)	(296)
Comprehensive income	$ 4,180	$ 5,093	$ 8,187	$ 10,871

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

(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 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, 2008 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, 2009 are not necessarily indicative of the results for the entire year.

(a) 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.

7

Table of Contents

(b) Securities

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

June 30, 2009 **Securities available for sale**		**Amortized Cost**		**Unrealized Gains**		**Losses**		**Fair Value**
U.S. Treasury and other U.S. government obligations	$	2,998	$	85	$		$	3,083
Government sponsored enterprise obligations		131,143		1,586				132,729
Total government securities		134,141		1,671				135,812
Mortgage-backed securities - GNMA		34,828		601		20		35,409
Mortgage-backed securities - government agencies		18,805		175		7		18,973
Total mortgage-backed securities		53,633		776		27		54,382
Obligations of states and political subdivisions		29,585		871		39		30,417
Trust preferred securities of financial institutions		3,233				675		2,558
Total securities available for sale	$	220,592	$	3,318	$	741	$	223,169

December 31, 2008 **Securities available for sale**		**Amortized Cost**		**Unrealized Gains**		**Losses**		**Fair Value**
U.S. Treasury and other U.S. government obligations	$	6,796	$	159	$		$	6,955
Government sponsored enterprise obligations		104,137		3,480				107,617
Total government securities		110,933		3,639				114,572
Mortgage-backed securities - GNMA		22,256		320		10		22,566
Mortgage-backed securities - government agencies		6,642		59		4		6,697
Total mortgage-backed securities		28,898		379		14		29,263
Obligations of states and political subdivisions		26,441		712		69		27,084
Trust preferred securities of financial institutions		3,233				781		2,452
Total securities available for sale	$	169,505	$	4,730	$	864	$	173,371

Table of Contents

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

June 30, 2009 Securities held to maturity	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2009				
Mortgage-backed securities - government agencies	$ 39	$ 2	$	$ 41
	$ 39	$ 2	$	$ 41

December 31, 2008 Securities held to maturity	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2008				
Mortgage-backed securities - government agencies	$ 43	$ 1	$	$ 44
	$ 43	$ 1	$	$ 44

A summary of securities as of June 30, 2009 based on maturity is presented below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

	Securities Available for Sale		Securities Held to Maturity	
(In thousands)	Amortized Cost	Approximate Fair Value	Amortized Cost	Approximate Fair Value
Due within one year	$ 94,157	$ 94,287	$	$
Due within one year through five years	40,537	41,713		
Due within five years through ten years	34,877	35,926	28	30
Due after ten years	51,021	51,243	11	11
	$ 220,592	$ 223,169	$ 39	$ 41

Table of Contents

Securities with unrealized losses at June 30, 2009 and December 31, 2008, not recognized in income 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, 2009						
Mortgage-backed securities - GNMA	$ 8,360	$ 20	$	$	$ 8,360	$ 20
Mortgage-backed securities - government agencies	3,493	7			3,493	7
Obligations of states and political subdivisions	2,312	39			2,312	39
Trust preferred securities of financial institutions			2,558	675	2,558	675
Total temporarily impaired securities	$ 14,165	$ 66	$ 2,558	$ 675	$ 16,723	$ 741
December 31, 2008						
Mortgage-backed securities - government agencies	$ 6,035	$ 14	$	$	$ 6,035	$ 14
Obligations of states and political subdivisions	4,259	69			4,259	69
Trust preferred securities of financial institutions	2,452	781			2,452	781
Total temporarily impaired securities	$ 12,746	$ 864	$	$	$ 12,746	$ 864

Table of Contents

The investment portfolio has 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 primarily 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 more likely than not 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. The Bancorp does not consider those investments to be other-than-temporarily impaired at June 30, 2009.

Debt securities with gross unrealized losses consist of 12 and 18 separate investment positions as of June 30, 2009 and December 31, 2008, respectively.

As of June 30, 2009, Bancorp has 3 securities totaling $2,558,000 which were impaired for 12 months or longer. At June 30, 2009, these trust preferred securities with a total amortized cost of $3,233,000 had an unrealized loss totaling $675,000 caused by interest rate changes and other market conditions. 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 June 30, 2009, management is of the opinion that none of the securities are other than temporarily impaired. Management does not intend to sell the investments, and it is not more likely than not that the Bancorp will be required to sell the investments before recovery of their amortized cost bases, which may be maturity. Volatility in these markets subsequent to June 30, 2009 could give rise to other-than-temporary impairment in the future.

Additional securities held by the Company at June 30, 2009 consist of the following:

Federal Home Loan Bank stock and other securities		**Cost**		**Fair Value**		**Unrealized Gain/(Loss)**
Federal Home Loan Bank stock	$	4,546	$	4,546	$	
Other non-marketable securities		1,001		1,001		
Total Federal Home Loan Bank stock and other securities	$	5,547	$	5,547	$	

(c) Stock-Based Compensation

On January 1, 2006, Bancorp adopted the modified version of prospective application of Statement of Financial Standard No. 123 (R) Share-based Payment , (SFAS No. 123R). Under this method, the fair value of all new and modified awards granted subsequent to the date of adoption is recognized as compensation expense, net of estimated forfeitures. Further, the fair value of any unvested awards at the date of adoption was recognized as compensation expense, net of estimated forfeitures.

Bancorp currently has one stock-based compensation plan. The 2005 Stock Incentive Plan reserved 735,000 shares of common stock for issuance of stock based awards. As of June 30, 2009, there were 151,399 shares available for future awards. Bancorp s 1995 Stock Incentive Plan expired in

Table of Contents

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.

In accordance with SFAS No. 123R, Bancorp recognized, within salaries and employee benefits in the consolidated statements of income, stock-based compensation expense of $179,900 and $218,000 before income taxes and a deferred tax benefit of $63,000 and $76,000 resulting in a reduction of net income of $116,900 and $142,000 for the second quarter of 2009 and 2008, respectively. For the six months ended June 30, 2009 and 2008, Bancorp recognized $328,200 and $363,000 of compensation expense before taxes, a deferred tax benefit of $114,900 and $127,000, and a reduction of net income of $213,300 and $236,000, respectively. Bancorp expects to record an additional $365,000 of stock-based compensation expense in 2009. As of June 30, 2009 Bancorp has $2,167,000 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 $768,000 and $422,000 from the exercise of options during the first six months of 2009 and 2008, respectively.

Under SFAS No. 123R, Bancorp is required to reduce future stock-based compensation expense by estimated forfeitures at the grant date. These forfeiture estimates are based on historical experience.

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:

	2009	**2008**
Dividend yield	2.11%	1.95%
Expected volatility	23.59	14.99
Risk free interest rate	3.11	3.84
Forfeitures	5.96	5.65
Expected life of options and SARs (in years)	7.7	7.5

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 for 2009 is the volatility of the underlying shares for the expected term on a monthly basis. Prior to 2009, volatility was calculated on a quarterly 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.

12

Table of Contents

A summary of stock option and SARs activity and related information for the six months ended June 30, 2009 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, 2008						
Vested and exercisable	783	$ 9.82-26.83	$ 19.03	$ 6,637	$ 4.14	4.67
Unvested	244	20.25-26.83	24.74	672	5.47	8.10
Total outstanding	1,027	9.82-26.83	20.39	7,309	4.46	5.48
Granted	102	22.14-24.30	22.15	206	5.36	
Exercised	(83)	9.82-18.62	12.83	916	2.48	
Forfeited	(6)	22.14-26.83	24.67	2	5.48	
At June 30, 2009						
Vested and exercisable	762	9.82-26.83	20.16	3,262	4.44	4.76
Unvested	278	20.90-26.83	23.80	265	5.41	8.43
Total outstanding	1,040	9.82-26.83	21.13	$ 3,527	4.70	5.74
Vested during quarter	2	20.25-24.02	20.78	$ 6	4.78	

The weighted average fair values of options and SARs granted in 2009 and 2008 were $5.36 and $4.57, respectively.

In the first quarter of 2009, Bancorp granted 102,100 SARs at the weighted average current market price of $22.15 and a fair value of $5.36. These SARs will vest 20% per year over the next five years. All SARs expire ten years from the date of grant. Also, in the first quarter of 2009, Bancorp granted 25,542 shares of restricted common stock at the weighted average current market price of $22.15. These grants generally vest over three to five years, with limited exceptions of shorter vesting schedules due to anticipated retirement.

Table of Contents

(2) Impaired Loans and Allowance for Loan Losses

An analysis of the changes in the allowance for loan losses for the six months ended June 30, 2009 and 2008 follows (in thousands):

	2009	2008
Beginning balance January 1,	$ 15,381	$ 13,450
Provision for loan losses	3,825	2,200
Loans charged off	(2,458)	(1,537)
Recoveries	329	343
Ending balance June 30,	$ 17,077	$ 14,456

Information about impaired loans follows (in thousands):

	June 30, 2009	December 31, 2008
Principal balance of impaired loans	$ 6,123	$ 4,455
Impaired loans with a valuation allowance	4,222	2,724
Amount of valuation allowance	1,126	1,255
Impaired loans with no valuation allowance	1,901	1,731
Average balance of impaired loans for the period	5,039	4,054

(3) Federal Home Loan Bank Advances

The Bank had outstanding borrowings of $90.5 million, at June 30, 2009, via six separate advances as detailed in the table below.

Amount	Type	Amortization	Maturity	Call Feature	Next Call Date
$ 30,000,000	Fixed rate	None	November 2009	Non callable	
20,000,000	Fixed rate	None	December 2010	Quarterly	September 2009
20,000,000	Fixed rate	None	May 2012	Quarterly	August 2009
10,000,000	Fixed rate	None	April 2012	Non callable	
10,000,000	Fixed rate	None	April 2014	Non callable	
458,000	Fixed rate	15 Year	April 2024	Non callable	
$ 90,458,000					

For the first five advances, interest payments are due monthly, with principal due at maturity. For the sixth advance, principal and interest payments are due monthly based on a 15 year amortization schedule. The weighted average rate of these six advances was 4.02% at June 30, 2009. 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 $91.4 million as of June 30, 2009 under terms to be established at the time of the advance. The Bank also has a standby letter of credit from the FHLB for $20 million outstanding at June 30, 2009. Under Kentucky law, customer cash balances in Investment Management and Trust accounts, may be retained as deposits in the Bank. Kentucky law requires these deposits above the 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.

(4) Goodwill

Statement of Financial Accounting Standards No. 142, Goodwill and Intangible Assets (SFAS No. 142), requires that goodwill and intangible assets with indefinite useful lives no longer 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.

Table of Contents

(5) 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. The plan is unfunded and benefits are paid from the Bank s assets. Information about the components of the net periodic benefit cost of the defined benefit plan follows (in thousands):

	Three months ended June 30		Six months ended June 30	
	2009	**2008**	**2009**	**2008**
Components of net periodic benefit cost:				
Service cost	$	$	$	$
Interest cost	26	28	52	55
Expected return on plan assets				
Amortization of prior service cost				
Amortization of the net loss	6	6	12	12
Net periodic benefit cost	$ 32	$ 34	$ 64	$ 67

(6) Commitments to Extend Credit

As of June 30, 2009, 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 financial statements. In management s opinion, commitments to extend credit of $382,900,000 including standby letters of credit of $31,788,000 represent normal banking transactions, and no significant losses are anticipated to result from these commitments as of June 30, 2009. Commitments to extend credit were $314,478,000, including letters of credit of $21,869,000, as of December 31, 2008. 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.

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 primarily 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.

Table of Contents

(7) 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 June 30, 2009.

(8) Net Income Per Share

The following table reflects, for the three and six months ended June 30, 2009 and 2008, net income (the numerator) and average shares outstanding (the denominator) for the basic and diluted net income per share computations (in thousands except per share data):

	Three months ended June		Six months ended June	
	2009	**2008**	**2009**	**2008**
Net income, basic and diluted	$ 4,288	$ 6,129	$ 9,025	$ 11,167
Average shares outstanding	13,564	13,409	13,532	13,431
Effect of dilutive securities	165	175	151	167
Average shares outstanding including dilutive securities	13,729	13,584	13,683	13,598
Net income per share, basic	$ 0.32	$ 0.46	$ 0.67	$ 0.83
Net income per share, diluted	$ 0.31	$ 0.45	$ 0.66	$ 0.82

(9) 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 individual 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, and retirement plan services.

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. 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 necessarily indicative of the segments operations, if they were independent entities.

16

Table of Contents

Selected financial information by business segment for the three and six month periods ended June 30, 2009 and 2008 follows:

	Three months ended June 30 2009		Three months ended June 30 2008		Six months ended June 30 2009		Six months ended June 30 2008	
	(In thousands)				(In thousands)			
Net interest income:								
Commercial banking	$	14,249	$	14,333	$	28,278	$	27,509
Investment management and trust		68		82		147		167
Total	$	14,317	$	14,415	$	28,425	$	27,676
Provision for loan losses:								
Commercial banking	$	2,200	$	975	$	3,825	$	2,200
Investment management and trust								
Total	$	2,200	$	975	$	3,825	$	2,200
Non-interest income:								
Commercial banking	$	5,263	$	4,419	$	9,153	$	8,617
Investment management and trust	$	2,801		3,238		5,472		6,517
Total		8,064	$	7,657	$	14,625	$	15,134
Non-interest expense:								
Commercial banking	$	12,327	$	10,722	$	23,074	$	21,313
Investment management and trust		1,703		1,610		3,225		3,089
Total	$	14,030	$	12,332	$	26,299	$	24,402
Tax expense								
Commercial banking	$	1,455	$	2,039	$	3,063	$	3,784
Investment management and trust		408		597		838		1,257
Total	$	1,863	$	2,636	$	3,901	$	5,041
Net income:								
Commercial banking	$	3,530	$	5,016	$	7,469	$	8,829
Investment management and trust		758		1,113		1,556		2,338
Total	$	4,288	$	6,129	$	9,025	$	11,167

Table of Contents

(10) Income Taxes

Financial Accounting Standards Board Interpretation No. 48 Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48) provides guidance on financial statement recognition and measurement of tax positions taken, or expected to be taken, in tax returns. As of December 31, 2008 and June 30, 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.

Bancorp s policy is to report interest and penalties, if any, related to unrecognized tax benefits in income tax expense. As of December 31, 2008 and June 30, 2009, the amount accrued for the potential payment of interest and penalties was $20,000.

(11) Fair Value Measurements

Effective January 1, 2008 the Company adopted FASB Statement No. 157, Fair Value Measurements . This statement is definitional and disclosure oriented and addresses how companies should approach measuring fair value when required by Generally Accepted Accounting Principals (GAAP); it does not create or modify any current GAAP requirements to apply fair value accounting. FASB Statement No. 157 prescribes various disclosures about financial statement categories and amounts which are measured at fair value, if such disclosures are not already specified elsewhere in GAAP. The adoption of FASB Statement No. 157 did not have an impact on Bancorp s consolidated financial statements. In February 2008 the FASB issued a statement delaying the effective date of Statement No. 157 for nonfinancial assets and nonfinancial liabilities except those that are recognized or disclosed at fair value on a recurring basis. Accordingly, the Company began applying Statement No. 157 to other real estate owned and goodwill in 2009.

Statement No. 157 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. Statement No. 157 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 our own 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.

Table of Contents

Our 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, we use our 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.

The Company 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. Certain 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.

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

	Fair Value at June 30, 2009			
Investment securities available for sale	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Treasury and other U.S. government obligations	$ 3,083	$	$ 3,083	$
Government sponsored enterprise obligations	132,729		132,729	
Total government securities	135,812		135,812	
Mortgage-backed securities - GNMA	35,409		35,409	
Mortgage-backed securities - government agencies	18,973		18,973	
Total mortgage-backed securities	54,382		54,382	
Obligations of states and political subdivisions	30,417		30,417	
Trust preferred securities of financial institutions	2,558	982	1,576	
Total investment securities available for sale	$ 223,169	$ 982	$ 222,187	$

Table of Contents

Investment securities available for sale	Fair Value at December 31, 2008 Total	Level 1	Level 2	Level 3
U.S. Treasury and other U.S. government obligations	$ 6,955	$	$ 6,955	$
Government sponsored enterprise obligations	107,617		107,617	
Total government securities	114,572		114,572	
Mortgage-backed securities - GNMA	22,566		22,566	
Mortgage-backed securities - government agencies	6,697		6,697	
Total mortgage-backed securities	29,263		29,263	
Obligations of states and political subdivisions	27,084		27,084	
Trust preferred securities of financial institutions	2,452	1,072	1,380	
Total investment securities available for sale	$ 173,371	$ 1,072	$ 172,299	$

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.

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.

The Company s investment in a domestic private equity fund is comprised of bank and other financial industry stocks, and this investment, included in other assets, is recorded using the equity method of accounting. Individual securities contained in the fund are priced using quoted prices of identical securities, quoted prices of similar securities and market-based models. 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.

The Company s investment in a bank in one of the Company s expansion markets, included in other assets, is recorded as an equity-method investment. As of June 30, 2009, the Company evaluated this investment for impairment based on a quoted price for this security in a market that is generally not active. Therefore, the measurement was classified as Level 2.

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.

Table of Contents

Statement of Financial Accounting Standards No. 142, Goodwill and Intangible Assets (SFAS No. 142), requires that goodwill no longer 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. Fair value is based on a valuation analysis that incorporates present value of financial assets of the commercial and retail banking segment of the Bank. The model incorporates assumptions that market participants would used in estimating future cash flows and their present value. These measurements are classified as Level 3.

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

	Fair value at June 30, 2009				
	Total	Level 1	Level 2	Level 3	Losses for 6 month period
Other real estate owned	$ 1,400	$	$	$ 1,400	$
Impaired loans	3,622			3,622	(388)
Total	$ 5,022	$	$ 0	$ 5,022	$ (388)

	Fair value at December 31, 2008			
	Total	Level 1	Level 2	Level 3
Mortgage servicing rights	$ 426	$	$	$ 426
Investment in domestic private equity fund	1,776		1,776	
Investment in bank in expansion market	520		520	
Impaired loans	1,469			1,469
Total	$ 4,191	$	$ 2,296	$ 1,895

Mortgage servicing rights (MSRs) are carried at the lower of cost or fair value. For the three and six months ended June 30, 2009, the MSR valuation allowance reversals were $20,000 and $176,000, respectively. Corresponding increases of $20,000 and $176,000 were included in earnings for the respective time periods. At June 30, 2009 there was no valuation allowance for the mortgage servicing rights, as the fair value exceeded the cost.

Loans are measured for impairment and, if indicated, a specific allocation is established based on the value of underlying collateral. At June 30, 2009, the carrying value of impaired loans, which include non-accrual loans and loans accounted for as troubled debt restructuring, with a specific allocation was $4,995,000 and the corresponding total allocation was $1,373,000. For the three and six months ended June 30, 2009, charge-offs of impaired loans totaled $247,000 and $561,000, respectively.

Table of Contents

(12) Fair Value of Financial Instruments

The estimated fair values of financial instruments at June 30, 2009 and December 31, 2008 are as follows:

	June 30, 2009		December 31, 2008	
(In thousands)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets				
Cash and short-term investments	$ 33,759	$ 33,759	$ 27,113	$ 27,113
Mortgage loans held for sale	15,459	15,627	2,950	3,097
Securities	223,208	223,210	173,414	173,415
Federal Home Loan Bank stock and other securities	5,547	5,547	4,324	4,324
Loans, net	1,381,602	1,403,443	1,334,256	1,363,152
Accrued interest receivable	5,715	5,715	5,955	5,955
Financial liabilities				
Deposits	$ 1,337,013	$ 1,347,752	$ 1,270,925	$ 1,283,281
Short-term borrowings	93,833	93,833	67,649	67,652
Long-term borrowings	131,388	141,097	110,960	124,490
Accrued interest payable	582	582	690	690
Off balance sheet financial instruments				
Commitments to extend credit				
Standby letters of credit		(477)		(328)

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 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.

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

Rates currently available to Bancorp for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.

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 six months ended June 30, 2009 and compares this period with the same period 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 six months of 2009 compared to the year ended December 31, 2008. This discussion should be read in conjunction with the 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

Table of Contents

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 2009 through June 30

The Company completed the second quarter and first six months of 2009 with net income less than the comparable periods of 2008 by 30.0% and 19.2%, respectively. Diluted earnings per share for the second quarter and first six months of 2009 declined 31.1% and 19.5%, respectively. The decrease is due to continued pressure on net interest margin, a higher provision for loan losses, decreasing non-interest income and increasing non-interest expenses, particularly in FDIC insurance. These results are partially offset by the positive effect on interest income of strong growth in the loan portfolio, as well as increases in the investment securities portfolio.

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.

The company saw a decline in net interest margin of 43 basis points for the second quarter of 2009 as compared to the year earlier period and 29 basis points for the first six months of 2009 as compared to the same period in 2008. This margin erosion reflected the declining interest rate environment of the past year, higher interest expense in the current year related to the Company s December 2008 issuance of the trust preferred securities, and the impact of maintaining a significantly higher liquidity position in 2009, which management considers prudent given the current operating environment.

The Bank increased its provision for loan losses to $2,200,000 in the second quarter from $975,000 in the second quarter of 2008. For the first six months of 2009, the provision totaled $3,825,000, compared to $2,200,000 for the same period in 2008. The elevated provision for loan losses was in response to ongoing recessionary pressures that resulted in a higher level of non-performing loans and some deterioration in other credit quality metrics. While the Company s asset quality remains strong despite turmoil in the economy, management continues to be concerned about and regularly monitors the loan portfolio for the effects of well-publicized economic challenges. The Company s allowance for loan losses was 1.22% of total loans at June 30, 2009, compared with 1.14% of total loans at December 31, 2008, and 1.09% at June 30, 2008.

Non-performing loans at June 30, 2009 were $8,820,000 or 0.63% relative to total loans, an increase from $4,710,000 or 0.35% at December 31, 2008, and an increase from $5,481,000 or 0.42% in the second quarter of 2008. Net charge-offs totaled $1,331,000 or 0.10% of average loans in the second quarter of 2009 compared with $616,000 or 0.05% in the same period last year. For the first six months of 2009, net charge-offs totaled $2,129,000, or 0.15% of average loans, compared to $1,194,000 or 0.09% of average loans in the same period of 2008. Management continues to believe it has appropriately recognized the loan-loss exposure in its portfolio.

Higher non-interest income by 5.3% for the second quarter of 2009 as compared to 2008 was primarily due to increased gains on sales of mortgage loans, which rose 39% compared to the same period in 2008, higher

Table of Contents

bankcard transaction revenue, and higher other non-interest income, primarily due to realized and unrealized gains of the Company s investment in a domestic private equity fund as well as increased income related to mortgage banking. Some of this increase was offset by lower investment management and trust service income, service charges on deposit accounts, brokerage commissions and fees, and bank owned life insurance (BOLI) income. Non-interest income for the first half of 2009 decreased 3.4% from the same period in 2008, due to lower investment management and trust service income, service charges on deposit accounts, brokerage commissions and fees, and BOLI income, partially offset by increased gains on sales of mortgage loans, bankcard transaction revenue, and other non-interest income.

Higher non-interest expense in the second quarter of 2009 was primarily due to significantly higher FDIC premiums as well as a special assessment of $786,000. Other factors contributing to the increase include higher salaries and benefits, data processing expenses, furniture and fixtures expense and state bank taxes, partially offset by decreases in other non-interest expenses. Non-interest expense increased in the first half of 2009 compared to the same period in 2008 due to the same factors. The Company s second quarter efficiency ratio was 61.96% compared with 58.61% in the first quarter of 2009, and 55.25% in the second quarter last year. The Company s efficiency ratio for the first half of 2009 was 60.35%, compared with 56.26% for the first half of 2008.

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. It is calculated by subtracting the value of intangible assets and any preferred equity from the book value of the Company. At June 30, 2009, our TCE was $148.8 million, or $10.96 per share, compared with book value per share of $11.01 based on total equity. At December 31, 2008, our TCE was $143.8 million, or $10.67 per share, compared with book value per share of $10.72 based on total equity. See the Non-GAAP Financial Measures section for details on reconcilement to GAAP measures.

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

a) Results Of Operations

Net income of $4,288,000 for the three months ended June 30, 2009 decreased $1,841,000, or 30.0%, from $6,129,000 for the comparable 2008 period. Basic net income per share was $0.32 for the second quarter of 2009, compared to $0.46 for the second quarter of 2008. Net income per share on a diluted basis was $0.31 for the second quarter of 2009 compared to $0.45 for the second quarter of 2008. Annualized return on average assets and annualized return on average stockholders equity were 1.01% and 11.53%, respectively, for the second quarter of 2009, compared to 1.60% and 18.30%, respectively, for the same period in 2008.

Net income of $9,025,000 for the six months ended June 30, 2009 decreased $2,142,000, or 19.2%, from $11,167,000 for the comparable 2008 period. Basic net income per share was $0.67 for the first six months of 2009, compared to $0.83 for the same period of 2008. Net income per share on a diluted basis was $0.66 for the first six months of 2009 compared to $0.82 for the same period of 2008. Annualized return on average assets and annualized return on average stockholders equity were 1.10% and 12.33%, respectively, for the first six months of 2009, compared to 1.49% and 16.85%, respectively, for the same period in 2008.

Net Interest Income

The following tables present the average balance sheets for the three and six month periods ended June 30, 2009 and 2008 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.

Table of Contents

	Three months ended June 30					
	2009			2008		
(Dollars in thousands)	Average Balances	Interest	Average Rate	Average Balances	Interest	Average Rate
Earning assets:						
Federal funds sold	$ 30,751	$ 17	0.22%	$ 16,690	$ 84	2.02%
Mortgage loans held for sale						
Securities:	7,953	105	5.30%	6,333	87	5.53%
Taxable	137,466	1,137	3.32%	81,330	972	4.81%
Tax-exempt	28,010	406	5.81%	24,580	352	5.76%
FHLB stock and other securities	5,096	50	3.94%	4,126	38	3.70%
Loans, net of unearned income	1,390,379	19,346	5.58%	1,308,304	20,191	6.21%
Total earning assets	1,599,655	21,061	5.28%	1,441,363	21,724	6.06%
Less allowance for loan losses	16,691			14,501		