

S Y BANCORP INC  
Form 10-Q  
November 07, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2008

OR

**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)

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**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  No

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

|  |                          |                                  |                                     |
|--|--------------------------|----------------------------------|-------------------------------------|
| <b>Large accelerated filer</b>   | <input type="checkbox"/> | <b>Accelerated filer</b>         | <input checked="" type="checkbox"/> |
| <b>Non-accelerated filer</b> (Do not check if a smaller reporting company) | <input type="checkbox"/> | <b>Smaller reporting company</b> | <input type="checkbox"/>            |

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

Yes  No

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

Common Stock, no par value 13,461,890

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Shares issued and outstanding at October 30, 2008

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**S.Y. BANCORP, INC. AND SUBSIDIARY**



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**PART I FINANCIAL INFORMATION**



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### Item 1. Financial Statements

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

Unaudited Condensed Consolidated Balance Sheets  
September 30, 2008 and December 31, 2007

Unaudited Condensed Consolidated Statements of Income  
for the three months and nine months ended September 30, 2008 and 2007

Unaudited Condensed Consolidated Statements of Cash Flows  
for the nine months ended September 30, 2008 and 2007

Unaudited Condensed Consolidated Statement of Changes in Stockholders  
Equity  
for the nine months ended September 30, 2008

Unaudited Condensed Consolidated Statements of Comprehensive Income  
for the three and nine months ended September 30, 2008 and 2007

Notes to Unaudited Condensed Consolidated Financial Statements

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

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### **PART II OTHER INFORMATION**



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Unregistered Sales of Equity Securities and Use of Proceeds



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Unaudited Condensed Consolidated Balance Sheets  
September 30, 2008 and December 31, 2007

(In thousands, except share data)

|   | September 30,<br>2008<br>(Unaudited) | December 31,<br>2007 |
|---|--------------------------------------|----------------------|
| <b>Assets</b>   |                                      |                      |
| Cash and due from banks   | \$ 35,545                            | \$ 38,907            |
| Federal funds sold  | 21,571                               | 422                  |
| Mortgage loans held for sale  | 2,216                                | 4,771                |
| Securities available for sale (amortized cost of \$203,630 in 2008 and \$161,927 in 2007)   | 203,783                              | 162,549              |
| Securities held to maturity (fair value of \$46 in 2008 and \$1,128 in 2007)  | 44                                   | 1,129                |
| Federal Home Loan Bank stock  | 4,324                                | 3,931                |
| Loans   | 1,316,661                            | 1,201,938            |
| Less allowance for loan losses  | 14,785                               | 13,450               |
| Net loans   | 1,301,876                            | 1,188,488            |
| Premises and equipment, net   | 28,239                               | 27,195               |
| Bank owned life insurance   | 23,895                               | 23,122               |
| Accrued interest receivable and other assets  | 31,963                               | 31,705               |
| Total assets  | \$ 1,653,456                         | \$ 1,482,219         |
| <b>Liabilities and Stockholders Equity</b>  |                                      |                      |
| Deposits:   |                                      |                      |
| Non-interest bearing  | \$ 184,647                           | \$ 170,477           |
| Interest bearing  | 1,081,319                            | 936,230              |
| Total deposits  | 1,265,966                            | 1,106,707            |
| Securities sold under agreements to repurchase and federal funds purchased  | 98,520                               | 108,699              |
| Other short-term borrowings   | 15,435                               | 10,665               |
| Accrued interest payable and other liabilities  | 34,565                               | 33,034               |
| Federal Home Loan Bank advances   | 90,000                               | 90,000               |
| Subordinated debentures   | 10,060                               | 90                   |
| Total liabilities   | 1,514,546                            | 1,349,195            |
| Stockholders equity:  |                                      |                      |
| Preferred stock, no par value. Authorized 1,000,000 shares;<br>no shares issued or outstanding  |                                      |                      |
| Common stock, no par value. Authorized 20,000,000 shares; issued and outstanding<br>13,457,080 and 13,599,563 shares in 2008 and 2007, respectively | 5,747                                | 6,214                |
| Additional paid-in capital  | 7,158                                | 9,821                |
| Retained earnings   | 126,146                              | 116,906              |
| Accumulated other comprehensive income (loss)   | (141)                                | 83                   |
| Total stockholders equity   | 138,910                              | 133,024              |
| Total liabilities and stockholders equity   | \$ 1,653,456                         | \$ 1,482,219         |

See accompanying notes to unaudited condensed consolidated financial statements.



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Unaudited Condensed Consolidated Statements of Income  
For the three and nine months ended September 30, 2008 and 2007

(In thousands, except per share data)

|  | For three months ended<br>September 30, |           | For nine months ended<br>September 30, |           |
|--|---|-----------|--|-----------|
|  | 2008                                    | 2007      | 2008                                   | 2007      |
| <b>Interest income:</b>  |   |           |  |           |
| Loans  | \$ 20,254                               | \$ 21,290 | \$ 60,636                              | \$ 63,164 |
| Federal funds sold   | 313                                     | 168       | 452                                    | 756       |
| Mortgage loans held for sale   | 39                                      | 57        | 187                                    | 181       |
| Securities taxable   | 1,423                                   | 1,294     | 3,625                                  | 3,516     |
| Securities tax-exempt  | 259                                     | 263       | 743                                    | 822       |
| Total interest income  | 22,288                                  | 23,072    | 65,643                                 | 68,439    |
| <b>Interest expense:</b>   |   |           |  |           |
| Deposits   | 6,342                                   | 7,855     | 19,003                                 | 23,540    |
| Securities sold under agreements to repurchase and federal funds purchased | 274                                     | 799       | 1,004                                  | 2,151     |
| Other short-term borrowings  | 169                                     | 11        | 396                                    | 17        |
| Federal Home Loan Bank advances  | 1,037                                   | 854       | 3,096                                  | 2,236     |
| Subordinated debentures  | 1                                       | 2         | 3                                      | 5         |
| Total interest expense   | 7,823                                   | 9,521     | 23,502                                 | 27,949    |
| Net interest income  | 14,465                                  | 13,551    | 42,141                                 | 40,490    |
| Provision for loan losses  | 900                                     | 850       | 3,100                                  | 2,090     |
| Net interest income after provision for loan losses                        | 13,565                                  | 12,701    | 39,041                                 | 38,400    |
| <b>Non-interest income:</b>  |   |           |  |           |
| Investment management and trust services                                   | 2,885                                   | 3,227     | 9,400                                  | 9,760     |
| Service charges on deposit accounts  | 2,196                                   | 2,260     | 6,305                                  | 6,482     |
| Bankcard transaction revenue   | 662                                     | 596       | 1,974                                  | 1,728     |
| Gains on sales of mortgage loans held for sale                             | 366                                     | 227       | 999                                    | 874       |
| Loss on sales of securities available for sale                             | (607)                                   |           | (607)                                  |           |
| Brokerage commissions and fees   | 413                                     | 498       | 1,298                                  | 1,443     |
| Bank owned life insurance income   | 263                                     | 250       | 773                                    | 733       |
| Other  | 396                                     | 498       | 1,347                                  | 1,470     |
| Total non-interest income  | 6,574                                   | 7,556     | 21,489                                 | 22,490    |
| <b>Non-interest expenses:</b>  |   |           |  |           |
| Salaries and employee benefits   | 6,824                                   | 6,865     | 21,318                                 | 20,104    |
| Net occupancy expense  | 1,121                                   | 917       | 3,166                                  | 2,737     |
| Data processing expense  | 840                                     | 979       | 2,488                                  | 3,045     |
| Furniture and equipment expense  | 290                                     | 291       | 842                                    | 873       |
| State bank taxes   | 340                                     | 326       | 994                                    | 815       |
| Other  | 2,505                                   | 2,149     | 7,295                                  | 6,811     |
| Total non-interest expenses  | 11,920                                  | 11,527    | 36,103                                 | 34,385    |
| Income before income taxes   | 8,219                                   | 8,730     | 24,427                                 | 26,505    |
| Income tax expense   | 2,776                                   | 2,843     | 7,817                                  | 8,617     |
| Net income   | \$ 5,443                                | \$ 5,887  | \$ 16,610                              | \$ 17,888 |
| <b>Net income per share:</b>   |   |           |  |           |
| Basic  | \$ 0.41                                 | \$ 0.42   | \$ 1.24                                | \$ 1.25   |
| Diluted  | 0.40                                    | 0.41      | 1.22                                   | 1.23      |
| <b>Average common shares:</b>  |   |           |  |           |
| Basic  | 13,435                                  | 14,185    | 13,432                                 | 14,299    |

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|         |        |        |        |        |
|---------|--------|--------|--------|--------|
| Diluted | 13,652 | 14,400 | 13,615 | 14,525 |
|---------|--------|--------|--------|--------|

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**S.Y. BANCORP, INC. AND SUBSIDIARY**Unaudited Condensed Consolidated Statements of Cash Flows  
For the nine months ended September 30, 2008 and 2007

(In thousands)

|   | 2008      | 2007      |
|---|-----------|-----------|
| Operating activities:   |           |           |
| Net income  | \$ 16,610 | \$ 17,888 |
| Adjustments to reconcile net income to net cash provided by operating activities:                     |           |           |
| Provision for loan losses   | 3,100     | 2,090     |
| Depreciation, amortization and accretion, net   | 1,884     | 1,930     |
| Deferred income tax benefit   | (630)     | (505)     |
| Loss on sale of securities available for sale   | 607       |           |
| Gains on sales of mortgage loans held for sale  | (999)     | (874)     |
| Origination of mortgage loans held for sale   | (76,633)  | (59,917)  |
| Proceeds from sale of mortgage loans held for sale  | 80,187    | 61,730    |
| Bank owned life insurance income  | (773)     | (733)     |
| Gain (loss) on the sale of other real estate  | (3)       | 28        |
| Stock compensation expense  | 534       | 386       |
| Excess tax benefits from share-based compensation arrangements  | (108)     | (33)      |
| Increase in accrued interest receivable and other assets  | (72)      | (9,498)   |
| Increase (decrease) in accrued interest payable and other liabilities                                 | 1,471     | (3)       |
| Net cash provided by operating activities   | 25,175    | 12,489    |
| Investing activities:   |           |           |
| Purchases of securities available for sale  | (243,762) | (62,029)  |
| Proceeds from sale of securities available for sale   | 3,344     |           |
| Proceeds from maturities of securities available for sale   | 197,674   | 62,985    |
| Proceeds from maturities of securities held to maturity   | 1,084     | 1,054     |
| Net increase in loans   | (117,649) | (6,946)   |
| Purchases of premises and equipment   | (2,940)   | (2,169)   |
| Proceeds from sale of other real estate   | 1,907     | 3,122     |
| Net cash used in investing activities   | (160,342) | (3,983)   |
| Financing activities:   |           |           |
| Net increase (decrease) in deposits   | 159,259   | (35,813)  |
| Net increase (decrease) in securities sold under agreements to repurchase and federal funds purchased | (10,179)  | 8,967     |
| Net increase in other short-term borrowings   | 4,770     | 267       |
| Proceeds from Federal Home Loan Bank advances   |           | 20,000    |
| Repayments of Federal Home Loan Bank advances   |           | (10,000)  |
| Issuance of subordinated debentures   | 10,000    |           |
| Repayments of subordinated debentures   | (30)      | (30)      |
| Issuance of common stock for options and dividend reinvestment plan                                   | 1,085     | 1,089     |
| Excess tax benefits from share-based compensation arrangements  | 108       | 33        |
| Common stock repurchases  | (5,382)   | (12,211)  |
| Cash dividends paid   | (6,677)   | (6,608)   |
| Net cash provided by (used in) financing activities   | 152,954   | (34,306)  |
| Net increase (decrease) in cash and cash equivalents  | 17,787    | (25,800)  |
| Cash and cash equivalents at beginning of period  | 39,329    | 59,678    |
| Cash and cash equivalents at end of period  | \$ 57,116 | \$ 33,878 |
| Supplemental cash flow information:   |           |           |
| Income tax payments   | \$ 6,010  | \$ 7,570  |

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|   |    |        |    |        |
|---|----|--------|----|--------|
| Cash paid for interest                          |    | 23,661 |    | 27,371 |
| Supplemental non-cash activity:                 |    |        |    |        |
| Transfers from loans to other real estate owned | \$ | 1,161  | \$ | 2,742  |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**S.Y. BANCORP, INC. AND SUBSIDIARY**Unaudited Condensed Consolidated Statement of Changes in Stockholders Equity  
For the nine months ended September 30, 2008

(In thousands, except per share data)

|   | Common stock |          | Additional      | Retained   | Accumulated   | Total      |
|---|--------------|----------|-----------------|------------|---------------|------------|
|   | Number of    | Amount   | Paid-in capital | earnings   | other         |            |
|   | shares       |          |                 |            | comprehensive |            |
|   |              |          |                 |            | income (loss) |            |
| Balance December 31, 2007   | 13,600       | \$ 6,214 | \$ 9,821        | \$ 116,906 | \$ 83         | \$ 133,024 |
| Net income  |              |          |                 | 16,610     |               | 16,610     |
| Change in accumulated other comprehensive loss, net of tax              |              |          |                 |            | (224)         | (224)      |
| Stock compensation expense  |              |          | 534             |            |               | 534        |
| Stock issued for stock options exercised and dividend reinvestment plan | 69           | 236      | 957             |            |               | 1,193      |
| Stock issued for non-vested restricted stock                            | 23           | 76       | 463             | (539)      |               |            |
| Cash dividends, \$0.51 per share  |              |          |                 | (6,845)    |               | (6,845)    |
| Shares repurchased or cancelled   | (235)        | (779)    | (4,617)         | 14         |               | (5,382)    |
| Balance September 30, 2008  | 13,457       | \$ 5,747 | \$ 7,158        | \$ 126,146 | \$ (141)      | \$ 138,910 |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**S.Y. BANCORP, INC. AND SUBSIDIARY**Unaudited Condensed Consolidated Statements of Comprehensive Income  
For the three and nine months ended September 30, 2008 and 2007

(In thousands)

|  | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |           |
|--|-------------------------------------|----------|------------------------------------|-----------|
|  | 2008                                | 2007     | 2008                               | 2007      |
| Net income   | \$ 5,443                            | \$ 5,887 | \$ 16,610                          | \$ 17,888 |
| Other comprehensive income (loss), net of tax:   |                                     |          |                                    |           |
| Unrealized gains (losses) on securities available for sale:  |                                     |          |                                    |           |
| Unrealized gains (losses) arising during the period<br>(net of tax of (\$173), \$454, (\$333), and \$380, respectively)          | (323)                               | 844      | (619)                              | 705       |
| Reclassification adjustment for securities losses realized in<br>income (net of tax of \$212, \$0, \$212, and \$0, respectively) | 395                                 |          | 395                                |           |
| Other comprehensive income (loss)  | 72                                  | 844      | (224)                              | 705       |
| Comprehensive income   | \$ 5,515                            | \$ 6,731 | \$ 16,386                          | \$ 18,593 |

See accompanying notes to unaudited condensed consolidated financial statements.

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**S.Y. BANCORP, INC. AND SUBSIDIARY**

**(1) Summary of Significant Accounting Policies**



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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 ). 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, 2007 included in S.Y. Bancorp, Inc. 's Annual Report on Form 10-K. Certain reclassifications have been made in the prior year financial statements to conform to current year classifications.

Interim results for the three and nine month periods ended September 30, 2008 are not necessarily indicative of the results for the entire year.

### (a) Critical Accounting Policies



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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.

(b) Securities



Investment securities consisted of the following at September 30, 2008.

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|  | Cost              | Fair Value        | Unrealized Gain/(Loss) |
|--|-------------------|-------------------|------------------------|
| <b><u>Securities available for sale</u></b>                |                   |                   |                        |
| U.S. Treasury securities                                   | \$ 6,795          | \$ 6,958          | \$ 163                 |
| Government agency securities                               | 137,558           | 137,963           | 405                    |
| Total government securities                                | 144,353           | 144,921           | 568                    |
| Mortgage backed securities - GNMA                          | 22,423            | 22,683            | 260                    |
| Mortgage backed securities - government agencies           | 7,043             | 7,028             | (15)                   |
| Total mortgage backed securities                           | 29,466            | 29,711            | 245                    |
| Tax-exempt securities                                      | 26,578            | 26,834            | 256                    |
| Trust preferred securities of other financial institutions | 3,233             | 2,317             | (916)                  |
| <b>Total securities available for sale</b>                 | <b>\$ 203,630</b> | <b>\$ 203,783</b> | <b>\$ 153</b>          |
| <b><u>Securities held to maturity</u></b>                  |                   |                   |                        |
| Mortgage backed securities - government agencies           | \$ 44             | \$ 46             | \$ 2                   |
| <b>Total securities held to maturity</b>                   | <b>\$ 44</b>      | <b>\$ 46</b>      | <b>\$ 2</b>            |
| <b><u>Federal Home Loan Bank stock</u></b>                 |                   |                   |                        |
| Federal Home Loan Bank stock                               | \$ 4,324          | \$ 4,324          | \$                     |
| <b>Total Federal Home Loan Bank stock</b>                  | <b>\$ 4,324</b>   | <b>\$ 4,324</b>   | <b>\$</b>              |

Unrealized losses on Bancorp's investment securities portfolio have not been recognized in income because the securities are of high credit quality, management has the intent and the ability to hold for the foreseeable future, and the decline in fair values is largely due to changes in the prevailing interest rate and credit environment since the purchase date. 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.

Debt securities with gross unrealized losses consist of 49 and 41 separate investment positions as of September 30, 2008 and December 31, 2007, respectively.

As of September 30, 2008, Bancorp has 5 securities which were temporarily impaired for 12 months or longer, all of which are debt securities. These securities, which have a total fair value of \$1,473,000, have an unrealized loss of \$23,000.

In the third quarter of 2008, the Bancorp sold \$4,125,000 par of preferred securities of financial companies, generating a loss of \$607,000 and eliminating the Company's position in these types of securities. Management has the intent and ability to hold all remaining investment securities available for sale for the foreseeable future.

The Company's investment in a domestic private investment fund is comprised of bank and other financial industry stocks and is carried at cost in accordance with Statement of Position 78-9. This investment was previously included in securities available for sale, and was reclassified to other assets in the third quarter of 2008.



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**S.Y. BANCORP, INC. AND SUBSIDIARY**

Management evaluates the impairment of securities on a quarterly basis, considering various factors including issuer financial condition, agency rating, payment prospects, impairment duration and general industry condition. Based on the evaluation as of September 30, 2008, management is of the opinion that none of the investment securities are other than temporarily impaired.

(c) Stock-Based Compensation



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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 will be 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 September 30, 2008, there were 272,225 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 have been subject to a vesting schedule of 20% per year except for those granted to certain executive officers which vest six months after grant date. Restricted shares vest over two to five years. 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.

As a result of applying the provisions of SFAS No. 123R, Bancorp recognized, within salaries and employee benefits in the consolidated statements of income, stock-based compensation expense of \$534,000 and \$386,000 before income taxes and a deferred tax benefit of \$187,000 and \$135,000 resulting in a reduction of net income of \$347,000 and \$251,000 for the nine months ended September 30, 2008 and 2007, respectively. For the third quarter of 2008 and 2007, Bancorp recognized \$171,000 and \$144,000 of compensation expense before taxes, a deferred tax benefit of \$60,000 and \$50,000, and a reduction of net income of \$111,000 and \$94,000, respectively. Bancorp expects to record an additional \$127,000 of compensation expense in 2008. As of September 30, 2008 Bancorp has \$1,558,000 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 \$1,035,000 and \$1,037,000 from the exercise of options during the first nine months of 2008 and 2007, respectively.

In accordance with the Financial Accounting Standards Board Staff Position SFAS No. 123R 3, Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards , Bancorp elected the alternative transition method to calculate the beginning balance of the pool of excess tax benefits. The beginning balance of excess tax benefits was calculated as the sum of all net increases in additional paid-in-capital related to tax benefits from stock-based employee compensation, less the incremental stock-based after-tax compensation costs that would have been recognized if the fair value recognition provisions of SFAS No. 123 had been used to account for stock-based compensation costs.

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.

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**S.Y. BANCORP, INC. AND SUBSIDIARY**

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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:

|  | 2008  | 2007  |
|--|-------|-------|
| Dividend yield                               | 1.95% | 1.81% |
| Expected volatility                          | 14.99 | 14.49 |
| Risk free interest rate                      | 3.84  | 4.69  |
| Forfeitures                                  | 5.65  | 5.55  |
| Expected life of options and SARs (in years) | 7.5   | 7.7   |

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

The dividend yield and expected volatility are based on historical information corresponding to the expected life of awards granted. The expected volatility is the volatility of the underlying shares for the expected term on a 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.

A summary of stock option and SARs activity and related information for the nine months ended September 30, 2008 follows. The number of options and SARs and aggregate intrinsic value are stated in thousands.

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|                              | <b>Options<br/>and SARs</b> | <b>Exercise Price</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> | <b>Weighted<br/>Average<br/>Fair<br/>Value</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Life</b> |
|------------------------------|-----------------------------|-----------------------|--|--|--|--|
| <b>At December 31, 2007</b>  |                             |                       |  |  |  |  |
| Vested and exercisable       | 800                         | \$ 9.76-26.83         | \$ 18.10   | \$ 4,794                                 | \$ 3.90  |  |
| Unvested                     | 216                         | 18.05-26.83           | 25.42  | 13                                       | 5.96   |  |
| <b>Total outstanding</b>     | <b>1,016</b>                | <b>9.76-26.83</b>     | <b>19.65</b>                                       | <b>4,807</b>                             | <b>4.34</b>                                    |  |
| Granted                      | 114                         | 23.37                 | 23.37  | 827                                      | 4.57   |  |
| Exercised                    | (69)                        | 9.76-26.83            | 15.16  | 706                                      | 3.08   |  |
| Forfeited                    | (13)                        | 22.81-26.83           | 24.48  | 84                                       | 5.43   |  |
| <b>At September 30, 2008</b> |                             |                       |  |  |  |  |
| Vested and exercisable       | 801                         | 9.82-26.83            | 18.91  | 9,379                                    | 4.10   | 4.86   |
| Unvested                     | 247                         | 20.25-26.83           | 24.75  | 1,449                                    | 5.48   | 8.41   |
| <b>Total outstanding</b>     | <b>1,048</b>                | <b>9.82-26.83</b>     | <b>20.29</b>                                       | <b>\$ 10,828</b>                         | <b>4.43</b>                                    | <b>5.70</b>  |
| Vested during quarter        | 23                          | 18.05-23.37           | 23.27  | \$ 170                                   | 4.56   |  |

The weighted average fair values of options and SARs granted in 2008 and 2007 were \$4.57 and \$6.14, respectively.

In February 2008, Bancorp adopted a stock appreciation rights program under the terms of the Company's 2005 Stock Incentive Plan and granted 114,195 SARs at the current market price of \$23.37 and a fair value of \$4.57. Of these SARs, 22,700 were granted to certain executive officers and vested in the third quarter of 2008. Other awards will primarily vest 20% per year over the next five years. All SARs expire ten years from the date of grant.

Also, in February 2008, Bancorp granted 23,043 shares of common stock at the weighted average current market price of \$23.44. These grants vest over two to five years. As of September 30, 2008, 590 restricted shares had been forfeited. In the first nine months of 2008, 4,752 restricted shares granted in 2007 vested.

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**S.Y. BANCORP, INC. AND SUBSIDIARY**

(2) Allowance for Loan Losses



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An analysis of the changes in the allowance for loan losses for the nine months ended September 30, 2008 and 2007 follows (in thousands):

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|                              | <b>2008</b> | <b>2007</b> |
|------------------------------|-------------|-------------|
| Beginning balance January 1, | \$ 13,450   | \$ 12,203   |
| Provision for loan losses    | 3,100       | 2,090       |
| Loans charged off            | (2,310)     | (2,447)     |
| Recoveries                   | 545         | 704         |
| Ending balance September 30, | \$ 14,785   | \$ 12,550   |

(3) Federal Home Loan Bank Advances



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The Bank had outstanding borrowings of \$90 million, at September 30, 2008, via four separate advances. The first two are fixed rate, non-callable advances of \$20 million and \$30 million. The third advance of \$20 million is a fixed rate advance eligible to be called by the FHLB in December of 2008, and then quarterly going forward until its maximum maturity in December of 2010. The fourth advance of \$20 million is a fixed rate advance eligible to be called by the FHLB in November of 2008 and then quarterly going forward until its maximum maturity in May of 2012. The weighted average rate of these advances was 4.58% at September 30, 2008. Interest payments are due monthly, with principal due at maturity. 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 \$21.2 million as of September 30, 2008 under terms to be established at the time of the advance. The Bank also has a standby letter of credit from the FHLB for \$30 million outstanding at September 30, 2008. Under Kentucky law, customer cash balances in Investment Management and Trust accounts, may be retained as deposits in the Bank. As a part of this transaction, 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) Intangible Assets



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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.

### (5) Defined Benefit Retirement Plan



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The Bank sponsors an unfunded, non-qualified, defined benefit retirement plan for certain key officers. Benefits vest based on years of service. The Bank does not make contributions to this plan. Information about the components of the net periodic benefit cost of the defined benefit plan follows (in thousands):

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**S.Y. BANCORP, INC. AND SUBSIDIARY**

|   | Three months ended September 30 |       | Nine months ended September 30 |        |
|---|---------------------------------|-------|--------------------------------|--------|
|   | 2008                            | 2007  | 2008                           | 2007   |
| <b>Components of net periodic benefit cost:</b> |                                 |       |                                |        |
| Service cost                                    | \$                              | \$    | \$                             | \$     |
| Interest cost                                   | 27                              | 28    | 82                             | 85     |
| Expected return on plan assets                  |                                 |       |                                |        |
| Amortization of prior service cost              |                                 |       |                                |        |
| Amortization of the net loss                    | 6                               | 7     | 18                             | 20     |
| Net periodic benefit cost                       | \$ 33                           | \$ 35 | \$ 100                         | \$ 105 |

(6) Commitments to Extend Credit



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As of September 30, 2008, 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 \$334,832,000 including standby letters of credit of \$21,262,000 represent normal banking transactions, and no significant losses are anticipated to result from these commitments as of September 30, 2008. Commitments to extend credit were \$360,604,000, including letters of credit of \$19,414,000, as of December 31, 2007. 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.

(7) Preferred Stock



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At Bancorp's 2003 annual meeting of shareholders, the shareholders approved an amendment to the Articles of Incorporation to create a class of preferred stock and authorize 1,000,000 shares of this preferred stock with no par value. The relative rights, preferences and other terms of this stock or any series within the class will be determined by the Board of Directors prior to any issuance. Some of this preferred stock will be used in connection with a shareholders' rights plan upon the occurrence of certain triggering events. None of this stock had been issued as of September 30, 2008.

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**S.Y. BANCORP, INC. AND SUBSIDIARY**

(8) Net Income Per Share



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The following table reflects, for the three and nine months ended September 30, 2008 and 2007, 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):

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|  | Three months ended<br>September 30 |          | Nine months ended<br>September 30 |           |
|--|------------------------------------|----------|-----------------------------------|-----------|
|  | 2008                               | 2007     | 2008                              | 2007      |
| Net income, basic and diluted                            | \$ 5,443                           | \$ 5,887 | \$ 16,610                         | \$ 17,888 |
| Average shares outstanding                               | 13,435                             | 14,185   | 13,432                            | 14,299    |
| Effect of dilutive securities                            | 217                                | 215      | 183                               | 226       |
| Average shares outstanding including dilutive securities | 13,652                             | 14,400   | 13,615                            | 14,525    |
| Net income per share, basic                              | \$ 0.41                            | \$ 0.42  | \$ 1.24                           | \$ 1.25   |
| Net income per share, diluted                            | \$ 0.40                            | \$ 0.41  | \$ 1.22                           | \$ 1.23   |

(9) Segments



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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 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.

Selected financial information by business segment for the three and nine month periods ended September 30, 2008 and 2007 follows:

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|                                 | Three months<br>ended September 30 |           | Nine months<br>ended September 30 |           |
|---------------------------------|------------------------------------|-----------|-----------------------------------|-----------|
|                                 | 2008                               | 2007      | 2008                              | 2007      |
|                                 | (In thousands)                     |           | (In thousands)                    |           |
| Net interest income (expense):  |                                    |           |                                   |           |
| Commercial banking              | \$ 14,384                          | \$ 13,503 | \$ 41,893                         | \$ 40,344 |
| Investment management and trust | 81                                 | 48        | 248                               | 144       |
| Total                           | \$ 14,465                          | \$ 13,551 | \$ 42,141                         | \$ 40,488 |
| Provision for loan losses:      |                                    |           |                                   |           |
| Commercial banking              | \$ 900                             | \$ 850    | \$ 3,100                          | \$ 2,090  |
| Investment management and trust |                                    |           |                                   |           |
| Total                           | \$ 900                             | \$ 850    | \$ 3,100                          | \$ 2,090  |
| Non-interest income:            |                                    |           |                                   |           |
| Commercial banking              | \$ 3,689                           | \$ 4,329  | \$ 12,089                         | \$ 12,732 |
| Investment management and trust | 2,885                              | 3,227     | 9,400                             | 9,760     |
| Total                           | \$ 6,574                           | \$ 7,556  | \$ 21,489                         | \$ 22,492 |
| Non-interest expense:           |                                    |           |                                   |           |
| Commercial banking              | \$ 10,456                          | \$ 9,888  | \$ 31,550                         | \$ 29,604 |
| Investment management and trust | 1,464                              | 1,639     | 4,553                             | 4,781     |
| Total                           | \$ 11,920                          | \$ 11,527 | \$ 36,103                         | \$ 34,385 |
| Tax expense                     |                                    |           |                                   |           |
| Commercial banking              | \$ 2,253                           | \$ 2,270  | \$ 6,037                          | \$ 6,824  |
| Investment management and trust | 523                                | 573       | 1,780                             | 1,793     |
| Total                           | \$ 2,776                           | \$ 2,843  | \$ 7,817                          | \$ 8,617  |
| Net income:                     |                                    |           |                                   |           |
| Commercial banking              | \$ 4,464                           | \$ 4,824  | \$ 13,295                         | \$ 14,558 |
| Investment management and trust | 979                                | 1,063     | 3,315                             | 3,330     |
| Total                           | \$ 5,443                           | \$ 5,887  | \$ 16,610                         | \$ 17,888 |

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**S.Y. BANCORP, INC. AND SUBSIDIARY**

(10) Subsequent Events



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Company management is carefully evaluating participation in the U.S. Treasury's recently announced voluntary capital purchase program. Under the program the Treasury will purchase senior preferred shares on terms standardized for all participants. Subscription amounts range from 1 to 3 percent of risk-weighted assets. For Bancorp, the Treasury investment would range from approximately \$14.4 million to \$43.3 million. Interested institutions must apply by mid-November 2008.

In October 2008, the FDIC announced the Temporary Liquidity Guarantee Program. The new program will (1) guarantee newly issued senior unsecured debt such as fed funds, and (2) provide full deposit insurance coverage for non-interest bearing deposit accounts regardless of the dollar amount. The program is automatic without cost until mid-November 2008. After that time, fees will be assessed by the FDIC to cover the cost of each part of the program. Institutions may opt out of either program by December 5, 2008. Company management is carefully evaluating participation in the first program, and intends to continue participation in the second program.

In October 2008 PNC agreed to acquire National City Bank. According to published FDIC deposit data, as of June 30, 2008, National City Bank ranked as having the largest market share, and PNC ranked as having the third largest market share in the Louisville MSA. The transaction is expected to occur by the end of 2008 and the effect of the transaction on the banking environment in Louisville, Bancorp's primary market, remains to be seen.

### (11) Income Taxes



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Bancorp adopted Financial Accounting Standards Board Interpretation No. 48 Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 ( FIN 48 ) in 2007. FIN 48 provides guidance on financial statement recognition and measurement of tax positions taken, or expected to be taken, in tax returns. The initial adoption of FIN 48 had no impact on the Company's financial statements. As of December 31, 2007 and September 30, 2008, 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. Federal and state income tax returns are subject to examination from the 2003 tax return year and forward. Management does not anticipate significant adjustments to the total amount of unrecognized tax benefits within the next twelve months.

Bancorp's policy is to report interest and penalties, if any, related to unrecognized tax benefits in income tax expense. As of January 1 and September 30, 2008, the amount accrued for the potential payment of interest and penalties was \$20,000.

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**S.Y. BANCORP, INC. AND SUBSIDIARY**

(12) Fair Value Measurements



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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 has deferred applying Statement No. 157 to other real estate owned and goodwill until 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.

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.

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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. The 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).

|  | Total      | Fair value at September 30, 2008 |            |         |
|--|------------|----------------------------------|------------|---------|
|  |            | Level 1                          | Level 2    | Level 3 |
| Investment securities available for sale | \$ 203,783 | \$ 960                           | \$ 202,823 | \$      |

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.

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

|                              | Total    | Fair value at September 30, 2008 |          |         |
|------------------------------|----------|----------------------------------|----------|---------|
|                              |          | Level 1                          | Level 2  | Level 3 |
| Mortgage loans held for sale | \$ 2,216 | \$                               | \$ 2,216 | \$      |
| Mortgage servicing rights    | 518      |                                  |          | 518     |
| Total                        | \$ 2,734 | \$                               | \$ 2,216 | \$ 518  |

The following represent impairment charges recognized during the period.

Mortgage servicing rights, which are carried at the lower of cost or fair value, were written down to fair value of \$518,000, resulting in a valuation allowance of \$25,000. A corresponding charge of \$25,000 was included in earnings for the period.



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Loans are measured for impairment and, if indicated, are written down based on the value of underlying collateral. In cases of real estate collateral, fair value is generally determined from external appraisals and assessment of values as estimated by management. In cases of non-real estate collateral, fair value is estimated using judgments and estimates of external professionals and of management. Many of these inputs are not observable and, accordingly, these measurements are classified as Level 3. At September 30, 2008, the carrying value of impaired loans with a valuation allowance was \$3,342,000 and the corresponding valuation allowance was \$1,214,000. The valuation allowance for impaired loans decreased \$74,000 from \$1,288,000 at June 30, 2008. Charge-offs of impaired loans totaled \$411,000 for the third quarter of 2008.

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

This item discusses the results of operations for S.Y. Bancorp, Inc. ( Bancorp or Company ), and its subsidiary, Stock Yards Bank & Trust Company ( Bank ) for the three and nine months ended September 30, 2008 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 nine months of 2008 compared to the year ended December 31, 2007. 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 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 2008 through September 30**



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Driven primarily by loan growth, the third quarter and first nine months of 2008 were marked by higher net interest income. However, net income was lower as compared to the year-earlier periods, due to continued pressure on net interest margin, a higher provision for loan losses, increasing non-interest expenses arising primarily from the Company's expansion, and decreasing non-interest income. Lower non-interest income was due to a decline in investment management and trust fees, combined with a loss on the sale of securities, partially offset by an increase in mortgage and bankcard transaction revenue. With these factors combined, the Company completed the third quarter and first nine months of 2008 with net income less than the comparable periods of 2007 by 7.5% and 7.1%, respectively. The impact of the Company's stock repurchase program over the past year helped mitigate the effect of lower net income on earnings per share. Diluted earnings per share for the third quarter and first nine months of 2008 was down 2.4% and 0.8%, respectively, compared to the year-earlier periods.

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

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**S.Y. BANCORP, INC. AND SUBSIDIARY**

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. Bancorp's loan totals at September 30, 2008 increased 9.5% compared to December 31, 2007. To support the growth, the Company aggressively sought deposits.

Net interest income increased 6.7% for the third quarter and 4.1% year to date compared with the year-earlier periods. The increase for 2008 was primarily due to strong loan growth in the first half of the year but was offset by the compression on net interest margin in the wake of rate cuts by the Federal Reserve as well as the effect of competitive factors, particularly on deposit rates. Net interest margin for the third quarter, at 3.78% decreased 29 basis points from the second quarter of 2008 and was 41 basis points lower than the 4.19% reported in the year-earlier period. For the first nine months ended September 30, 2008, net interest margin was 3.94% compared to 4.22% for the year-earlier period. This ongoing margin pressure, which began in the third quarter of 2006, reflects the drop in prevailing short-term interest rates coupled with the impact on interest rates associated with local competition for loans and deposits. In the second and third quarters of 2008, the Company increased its liquidity, primarily by increasing deposit rates. Deploying the liquidity in short term assets rather than loans had a negative impact on the net interest margin. The Company expects continued competitive pressures particularly on deposit rates will negatively impact net interest margins.

The Bank increased its provision for loan losses to \$900,000 in the third quarter from \$850,000 in the third quarter of 2007. For the first nine months of 2008, the provision totaled \$3,100,000, compared to \$2,090,000 for the same period in 2007. 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 macroeconomic challenges. The Company's allowance for loan losses was 1.12% of total loans at September 30, 2008, compared with 1.12% of total loans at December 31, 2007, and 1.08% at September 30, 2007.

Non-performing loans at September 30, 2008 were \$3,940,000 or 0.30% relative to total loans, an increase from \$3,370,000 or 0.28% at the end of the fourth quarter of 2007, and a decrease from \$5,481,000 or 0.42% in the second quarter of 2008. Net charge-offs totaled \$571,000 or 0.04% of average loans in the third quarter of 2008 compared with \$365,000 or 0.03% in the same period last year, and \$616,000 or .05% in the second quarter of 2008. Management continues to believe it has appropriately recognized the loan-loss exposure in its portfolio.

Non-interest income decreased 13.0% in the third quarter compared with the same quarter last year, primarily due to lower investment management and trust service income, service charges on deposit accounts and other non-interest income. Some of this decrease was offset by increased gains on sales of mortgage loans, which rose 61.2% compared to the same period in 2007, and higher bankcard transaction revenue, which rose 11.1% compared to the same period in 2007, along with bank owned life insurance (BOLI) and other non-interest income. In the third quarter of 2008, the Bancorp sold \$4,125,000 par of preferred securities of financial companies, generating a loss of \$607,000 and eliminating the Company's position in these types of securities. Management has the intent and ability to hold all remaining investment securities available for sale for the foreseeable future. Non-interest income decreased 4.4% in the first nine months of 2008 compared with the year-earlier period, again driven primarily by lower investment management and trust service income, combined with the loss on the securities sold.



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Non-interest expense increased 3.4% in the third quarter of 2008 versus the same period last year. Higher non-interest expense for 2008 was primarily due to increasing occupancy expenses in part from the development of a second office in the Indianapolis market and the Company's recent entry into the Cincinnati market. Non-interest expense increased 5.0% in the first nine months of 2008 compared with the year-earlier period. The Company's third quarter efficiency ratio was 55.97% compared with 55.13% in the second quarter of 2008 and 53.95% in the third quarter last year.

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

*a)* Results Of Operations



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Net income of \$5,443,000 for the three months ended September 30, 2008 decreased \$444,000, or 7.5%, from \$5,887,000 for the comparable 2007 period. Basic net income per share was \$0.41 for the third quarter of 2008, a decrease of 2.4% from the \$0.42 for the same period in 2007. Net income per share on a diluted basis was \$0.40 for the third quarter of 2008 compared to \$0.41 for the third quarter of 2007; a 2.4% decrease. As noted above, the impact of the Company's repurchase of 639,024 common shares in the past twelve months helped mitigate the effect of lower net income on earnings per share. Annualized return on average assets and annualized return on average stockholders' equity were 1.31% and 15.84%, respectively, for the third quarter of 2008, compared to 1.66% and 16.50%, respectively, for the same period in 2007.

Net income of \$16,610,000 for the nine months ended September 30, 2008 decreased \$1,278,000, or 7.1%, from \$17,888,000 from the comparable 2007 period. Basic net income per share was \$1.24 for the first nine months of 2008, a decrease of 0.8% from the \$1.25 for the same period in 2007. Net income per share on a diluted basis was \$1.22 for the first nine months of 2008, a decrease of 0.8% from the \$1.23 for the first nine months of 2007. Annualized return on average assets and annualized return on average stockholders' equity were 1.43% and 16.50%, respectively, for the first nine months of 2008, compared to 1.70% and 17.00%, respectively, for the same period in 2007.

### *Net Interest Income*



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The following tables present the average balance sheets for the three and nine month periods ended September 30, 2008 and 2007 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.

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| (Dollars in thousands)                       | Three months ended September 30 |                  |                 |                     |                  |                 |
|--|---------------------------------|------------------|-----------------|---------------------|------------------|-----------------|
|  | Average<br>Balances             | 2008<br>Interest | Average<br>Rate | Average<br>Balances | 2007<br>Interest | Average<br>Rate |
| <b>Earning assets:</b>                       |                                 |                  |                 |                     |                  |                 |
| Federal funds sold                           | \$ 66,224                       | \$ 313           | 1.88%           | \$ 12,404           | \$ 168           | 5.37%           |
| Mortgage loans held for sale                 | 2,657                           | 39               | 5.84%           | 3,369               | 57               | 6.71%           |
| Securities:                                  |                                 |                  |                 |                     |                  |                 |
| Taxable                                      | 137,462                         | 1,365            | 3.95%           | 107,195             | 1,234            | 4.57%           |
| Tax-exempt                                   | 25,190                          | 370              | 5.84%           | 27,159              | 377              | 5.51%           |
| FHLB stock                                   | 4,286                           | 58               | 5.38%           | 3,792               | 60               | 6.28%           |
| Loans, net of unearned income                | 1,315,401                       | 20,400           | 6.17%           | 1,155,211           | 21,437           | 7.36%           |
| <b>Total earning assets</b>                  | <b>1,551,220</b>                | <b>22,545</b>    | <b>5.78%</b>    | <b>1,309,130</b>    | <b>23,333</b>    | <b>7.07%</b>    |
| Less allowance for loan losses               | 14,816                          |                  |                 | 12,504              |                  |                 |
|  | 1,536,404                       |                  |                 | 1,296,626           |                  |                 |
| Non-earning assets:                          |                                 |                  |                 |                     |                  |                 |
| Cash and due from banks                      | 28,256                          |                  |                 | 35,284              |                  |                 |
| Premises and equipment                       | 28,504                          |                  |                 | 24,720              |                  |                 |
| Accrued interest receivable and other assets | 54,197                          |                  |                 | 53,023              |                  |                 |
| <b>Total assets</b>                          | <b>\$ 1,647,361</b>             |                  |                 | <b>\$ 1,409,653</b> |                  |                 |

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| (Dollars in thousands)   | Three months ended September 30 |                  |              |                     |                  |              |
|--|---------------------------------|------------------|--------------|---------------------|------------------|--------------|
|  | Average Balances                | 2008 Interest    | Average Rate | Average Balances    | 2007 Interest    | Average Rate |
| <b>Interest bearing liabilities:</b>                                       |                                 |                  |              |                     |                  |              |
| Deposits:  |                                 |                  |              |                     |                  |              |
| Interest bearing demand deposits   | \$ 204,898                      | \$ 201           | 0.39%        | \$ 204,458          | \$ 764           | 1.48%        |
| Savings deposits   | 43,426                          | 12               | 0.11%        | 41,595              | 49               | 0.47%        |
| Money market deposits  | 326,431                         | 1,456            | 1.77%        | 213,417             | 2,048            | 3.81%        |
| Time deposits  | 536,070                         | 4,673            | 3.47%        | 433,811             | 4,994            | 4.57%        |
| Securities sold under agreements to repurchase and federal funds purchased | 78,466                          | 274              | 1.39%        | 92,552              | 799              | 3.43%        |
| Other short-term borrowings  | 14,756                          | 169              | 4.56%        | 1,215               | 11               | 3.59%        |
| FHLB advances  | 90,000                          | 1,037            | 4.58%        | 70,000              | 854              | 4.84%        |
| Long-term debt   | 169                             | 1                | 2.35%        | 90                  | 2                | 8.82%        |
| <b>Total interest bearing liabilities</b>                                  | <b>1,294,216</b>                | <b>7,823</b>     | <b>2.40%</b> | <b>1,057,138</b>    | <b>9,521</b>     | <b>3.57%</b> |
| <b>Non-interest bearing liabilities:</b>                                   |                                 |                  |              |                     |                  |              |
| Non-interest bearing demand deposits                                       | 181,668                         |                  |              | 170,437             |                  |              |
| Accrued interest payable and other liabilities                             | 34,813                          |                  |              | 40,495              |                  |              |
| <b>Total liabilities</b>   | <b>1,510,697</b>                |                  |              | <b>1,268,070</b>    |                  |              |
| <b>Stockholders equity</b>   | <b>136,664</b>                  |                  |              | <b>141,583</b>      |                  |              |
| <b>Total liabilities and stockholders equity</b>                           | <b>\$ 1,647,361</b>             |                  |              | <b>\$ 1,409,653</b> |                  |              |
| <b>Net interest income</b>   |                                 | <b>\$ 14,722</b> |              |                     | <b>\$ 13,812</b> |              |
| <b>Net interest spread</b>   |                                 |                  | <b>3.38%</b> |                     |                  | <b>3.50%</b> |
| <b>Net interest margin</b>   |                                 |                  | <b>3.78%</b> |                     |                  | <b>4.19%</b> |

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| (Dollars in thousands)                       | Nine months ended September 30 |               |              |                     |               |              |
|--|--------------------------------|---------------|--------------|---------------------|---------------|--------------|
|  | Average Balances               | 2008 Interest | Average Rate | Average Balances    | 2007 Interest | Average Rate |
| <b>Earning assets:</b>                       |                                |               |              |                     |               |              |
| Federal funds sold                           | \$ 29,870                      | \$ 452        | 2.02%        | \$ 18,675           | \$ 756        | 5.41%        |
| Mortgage loans held for sale                 | 4,590                          | 187           | 5.44%        | 3,711               | 181           | 6.52%        |
| Securities:                                  |                                |               |              |                     |               |              |
| Taxable                                      | 105,973                        | 3,462         | 4.36%        | 100,795             | 3,336         | 4.43%        |
| Tax-exempt                                   | 25,012                         | 1,063         | 5.68%        | 28,327              | 1,177         | 5.56%        |
| FHLB stock                                   | 4,118                          | 163           | 5.29%        | 3,713               | 180           | 6.48%        |
| Loans, net of unearned income                | 1,286,403                      | 61,066        | 6.34%        | 1,152,709           | 63,630        | 7.38%        |
| <b>Total earning assets</b>                  | <b>1,455,966</b>               | <b>66,393</b> | <b>6.09%</b> | <b>1,307,930</b>    | <b>69,260</b> | <b>7.08%</b> |
| Less allowance for loan losses               | 14,369                         |               |              | 12,500              |               |              |
|  | 1,441,597                      |               |              | 1,295,430           |               |              |
| Non-earning assets:                          |                                |               |              |                     |               |              |
| Cash and due from banks                      | 27,326                         |               |              | 34,417              |               |              |
| Premises and equipment                       | 28,095                         |               |              | 24,780              |               |              |
| Accrued interest receivable and other assets | 54,661                         |               |              | 51,218              |               |              |
| <b>Total assets</b>                          | <b>\$ 1,551,679</b>            |               |              | <b>\$ 1,405,845</b> |               |              |

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| (Dollars in thousands)   | Nine months ended September 30 |                  |              |                     |                  |              |
|--|--------------------------------|------------------|--------------|---------------------|------------------|--------------|
|  | Average Balances               | 2008 Interest    | Average Rate | Average Balances    | 2007 Interest    | Average Rate |
| <b>Interest bearing liabilities:</b>                                       |                                |                  |              |                     |                  |              |
| Deposits:  |                                |                  |              |                     |                  |              |
| Interest bearing demand deposits   | \$ 209,736                     | \$ 823           | 0.52%        | \$ 210,909          | \$ 2,327         | 1.48%        |
| Savings deposits   | 42,361                         | 41               | 0.13%        | 42,031              | 152              | 0.48%        |
| Money market deposits  | 304,489                        | 4,765            | 2.09%        | 208,833             | 5,942            | 3.80%        |
| Time deposits  | 469,739                        | 13,374           | 3.80%        | 446,690             | 15,119           | 4.53%        |
| Securities sold under agreements to repurchase and federal funds purchased | 79,287                         | 1,004            | 1.69%        | 84,993              | 2,151            | 3.38%        |
| Other short-term borrowings  | 14,278                         | 396              | 3.70%        | 830                 | 17               | 2.74%        |
| FHLB advances  | 90,438                         | 3,096            | 4.57%        | 62,124              | 2,236            | 4.81%        |
| Long-term debt   | 97                             | 3                | 4.13%        | 95                  | 5                | 7.04%        |
| <b>Total interest bearing liabilities</b>                                  | <b>1,210,425</b>               | <b>23,502</b>    | <b>2.59%</b> | <b>1,056,505</b>    | <b>27,949</b>    | <b>3.54%</b> |
| <b>Non-interest bearing liabilities:</b>                                   |                                |                  |              |                     |                  |              |
| Non-interest bearing demand deposits                                       | 173,246                        |                  |              | 170,352             |                  |              |
| Accrued interest payable and other liabilities                             | 33,580                         |                  |              | 38,288              |                  |              |
| <b>Total liabilities</b>   | <b>1,417,251</b>               |                  |              | <b>1,265,145</b>    |                  |              |
| <b>Stockholders equity</b>   | <b>134,428</b>                 |                  |              | <b>140,700</b>      |                  |              |
| <b>Total liabilities and stockholders equity</b>                           | <b>\$ 1,551,679</b>            |                  |              | <b>\$ 1,405,845</b> |                  |              |
| <b>Net interest income</b>   |                                | <b>\$ 42,891</b> |              |                     | <b>\$ 41,311</b> |              |
| <b>Net interest spread</b>   |                                |                  | <b>3.50%</b> |                     |                  | <b>3.54%</b> |
| <b>Net interest margin</b>   |                                |                  | <b>3.94%</b> |                     |                  | <b>4.22%</b> |

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Notes to the average balance and interest rate tables:

- Net interest income, the most significant component of the Bank's earnings is total interest income less total interest expense. The level of net interest income is determined by the mix and volume of interest earning assets, interest bearing deposits and borrowed funds, and changes in interest rates.
- Net interest spread is the difference between the taxable equivalent rate earned on interest earning assets less the rate expensed on interest bearing liabilities.
- Net interest margin represents net interest income on a taxable equivalent basis as a percentage of average interest earning assets. Net interest margin is affected by both the interest rate spread and the level of non-interest bearing sources of funds, primarily consisting of demand deposits and stockholders' equity.
- Interest income on a fully tax equivalent basis includes the additional amount of interest income that would have been earned if investments in certain tax-exempt interest earning assets had been made in assets subject to federal taxes yielding the same after-tax income. Interest income on municipal securities and loans have been calculated on a fully tax equivalent basis using a federal income tax rate of 35%. The approximate tax equivalent adjustments to interest income were \$257,000 and \$261,000, respectively, for the three month periods ended September 30, 2008 and 2007, and \$750,000 and \$821,000, respectively, for the nine month periods ended September 30, 2008 and 2007.

Fully taxable equivalent net interest income of \$14,722,000 for the three months ended September 30, 2008 increased \$910,000, or 6.6%, from \$13,812,000 when compared to the same period last year. Net interest spread and net interest margin were 3.38% and 3.78%, respectively, for the third quarter of 2008 and 3.50% and 4.19%, respectively, for the third quarter of 2007.

Fully taxable equivalent net interest income of \$42,891,000 for the nine months ended September 30, 2008 increased \$1,580,000, or 3.8%, from \$41,311,000 when compared to the same period last year. Net interest spread and net interest margin were 3.50% and 3.94%, respectively, for the first nine months of 2008 and 3.54% and 4.22%, respectively, for the first nine months of 2007.

This ongoing margin pressure began in the third quarter of 2006 and reflects several forces. Approximately one third of the Company's loan portfolio is variable rate and reprices immediately when the prime rate changes. Of these variable rate loans, approximately \$246 million have reached their contractual floor of 4% or higher. These loans are primarily comprised of commercial and real estate loans. On October 29, 2008

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the Federal Reserve cut the target fed funds rate to 1%, prompting a decrease in the prime rate to 4% the following day. Additionally, at inception, the rates on fixed rate loans generally correlate to the five year Treasury and the persistence of low short term rates has held those rates low. Both factors have coupled with downward competitive pressure on loan rates and higher interest rates on deposits created by local competition. The Company expects pressure on net interest margins to continue, and further reductions in short-term rates by the Federal Reserve will negatively impact net interest spread and margin.

Average earning assets increased \$148 million or 11.3%, to \$1.456 billion for the first nine months of 2008 compared to 2007, reflecting growth in the loan portfolio, investment securities and short term earning assets. Average interest bearing liabilities increased \$153.9 million, or 14.6%, to \$1.210 billion for the first nine months of 2008 compared to 2007 primarily due to increases in money market, time deposits, and

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short term borrowings, partially offset by decreases in securities sold under agreements to repurchase and fed funds purchased. Approximately \$40.7 million of the increase in money market balances, and corresponding decreases in securities sold under agreement to repurchase, relates to the implementation of a non-collateralized sweep account in late 2007. There has been a gradual migration to non-collateralized sweep accounts from securities sold under agreement to repurchase.

Managing interest rate risk is fundamental for the financial services industry. The primary objective of interest rate risk management is to neutralize effects of interest rate changes on net income. Bank management evaluates interest rate sensitivity while attempting to optimize net interest income within the constraints of prudent capital adequacy, liquidity needs, market opportunities and customer requirements.

Bancorp uses an earnings simulation model to estimate and evaluate the impact of changing interest rates on earnings. The simulation model is designed to reflect the dynamics of interest earning assets, interest bearing liabilities and off-balance sheet financial instruments, in a one year forecast. By estimating the effects of interest rate increases and decreases, the model can reveal approximate interest rate risk exposure. The simulation model is used by management to gauge approximate results given a specific change in interest rates at a given point in time. The model is therefore a tool to indicate earnings trends in given interest rate scenarios and does not indicate actual expected results. The September 30, 2008 simulation analysis indicates that an increase in interest rates would have a positive effect on net interest income, and a decrease in interest rates would have a negative impact. These estimates are summarized below.

***Interest Rate Simulation Sensitivity Analysis***

|                | <b>Net interest<br/>income change</b> |
|----------------|---------------------------------------|
| Increase 200bp | 6.92%                                 |
| Increase 100bp | 3.44                                  |
| Decrease 100bp | (3.36)                                |
| Decrease 200bp | (6.75)                                |

*Provision for Loan Losses*



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The allowance for loan losses is based on management's continuing review and risk evaluation of individual loans, loss experience, current economic conditions, risk characteristics of the various categories of loans, and such other factors that, in management's judgment, require current recognition in estimating loan losses.

Management has established loan grading procedures which result in specific allowance allocations for any estimated inherent risk of loss. For all loans graded, but not individually reviewed, a general allowance allocation is computed using factors typically developed over time based on actual loss experience. The specific and general allocations plus consideration of qualitative factors represent management's best estimate of probable losses contained in the loan portfolio at the evaluation date. Although the allowance for loan losses is comprised of specific and general allocations the entire allowance is available to absorb any credit losses.

An analysis of the changes in the allowance for loan losses and selected ratios for the three and nine month periods ended September 30, 2008 and 2007 follows:

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| (Dollars in thousands)                        | Three months ended September 30 |              | Nine months ended September 30 |              |
|---|---------------------------------|--------------|--------------------------------|--------------|
|   | 2008                            | 2007         | 2008                           | 2007         |
| Balance at the beginning of the period        | \$ 14,456                       | \$ 12,065    | \$ 13,450                      | \$ 12,203    |
| Provision for loan losses                     | 900                             | 850          | 3,100                          | 2,090        |
| Loan charge-offs, net of recoveries           | (571)                           | (365)        | (1,765)                        | (1,743)      |
| Balance at the end of the period              | \$ 14,785                       | \$ 12,550    | \$ 14,785                      | \$ 12,550    |
| Average loans, net of unearned income         | \$ 1,315,401                    | \$ 1,155,211 | \$ 1,286,403                   | \$ 1,152,709 |
| Provision for loan losses to average loans    |                                 |              |                                |              |
| (1)   | 0.07%                           | 0.07%        | 0.24%                          | 0.18%        |
| Net loan charge-offs to average loans (1)     | 0.04%                           | 0.03%        | 0.14%                          | 0.15%        |
| Allowance for loan losses to average loans    | 1.12%                           | 1.09%        | 1.15%                          | 1.09%        |
| Allowance for loan losses to period-end loans | 1.12%                           | 1.08%        | 1.12%                          | 1.08%        |
| Allowance to nonperforming loans              | 375.25%                         | 295.71%      | 375.25%                        | 295.71%      |

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(1) Amounts not annualized

The provision for loan losses increased \$1,010,000 during the first nine months of 2008 as compared to 2007. The provision for loan losses for the period is calculated after considering credit quality factors, and ultimately relies on an overall internal analysis of the risk in the loan portfolio. Based on this detailed analysis of credit risk, management considers the allowance for loan losses adequate to cover probable losses inherent in the loan portfolio at September 30, 2008. Among many factors considered in determining the provision for loan losses are net charge-offs and non-performing loans. Net charge-offs increased \$22,000 for the first nine months of 2008 compared to the same period in 2007. Charge offs in the first nine months of 2007 included \$800,000 for one loan involving fraudulent collateral. Although the ratio of loan charge-offs to average loans increased to 0.04% in the third quarter of 2008 from 0.03% in 2007, management feels this trend is not entirely indicative of potential exposure in the portfolio given the current uncertainty in the general economy. The recent turmoil witnessed in the stock market, and particularly in the banking industry, has created new uncertainties for investors and consumers. These pressures add to the concern that surrounds the real estate downturn of the past year. In Louisville, our largest and principal market, growth and expansion traditionally have been steady, and the city largely has avoided the rapid run-up in real estate prices that occurred elsewhere, so this market has remained strong and resilient thus far. Still, it is impossible to predict if and to what extent the more pronounced national trends reach the local market. Clearly, conditions remain unsettled in the housing and credit markets, and, coupled with the recent severe downturn in the stock markets, it is impossible to predict how these interconnected factors will play out over the near term, or what their effects on future credit quality might be. Please refer to the Non-performing Loans and Assets section of this report for further information regarding asset quality.

***Non-interest Income and Expenses***



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The following table sets forth the major components of non-interest income and expenses for the three and nine month periods ended September 30, 2008 and 2007.

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| (In thousands)                                 | Three months<br>ended September 30 |           | Nine months<br>ended September 30 |           |
|--|------------------------------------|-----------|-----------------------------------|-----------|
|  | 2008                               | 2007      | 2008                              | 2007      |
| <b>Non-interest income:</b>                    |                                    |           |                                   |           |
| Investment management and trust services       | \$ 2,885                           | \$ 3,227  | \$ 9,400                          | \$ 9,760  |
| Service charges on deposit accounts            | 2,196                              | 2,260     | 6,305                             | 6,482     |
| Bankcard transaction revenue                   | 662                                | 596       | 1,974                             | 1,728     |
| Gains on sales of mortgage loans held for sale | 366                                | 227       | 999                               | 874       |
| Loss on sales of securities available for sale | (607)                              |           | (607)                             |           |
| Brokerage commissions and fees                 | 413                                | 498       | 1,298                             | 1,443     |
| Bank owned life insurance income               | 263                                | 250       | 773                               | 733       |
| Other  | 396                                | 498       | 1,347                             | 1,470     |
| Total non-interest income                      | \$ 6,574                           | \$ 7,556  | \$ 21,489                         | \$ 22,490 |
| <b>Non-interest expenses:</b>                  |                                    |           |                                   |           |
| Salaries and employee benefits                 | \$ 6,824                           | \$ 6,865  | 21,318                            | \$ 20,104 |
| Net occupancy expense                          | 1,121                              | 917       | 3,166                             | 2,737     |
| Data processing expense                        | 840                                | 979       | 2,488                             | 3,045     |
| Furniture and equipment expense                | 290                                | 291       | 842                               | 873       |
| State bank taxes                               | 340                                | 326       | 994                               | 815       |
| Other  | 2,505                              | 2,149     | 7,295                             | 6,811     |
| Total non-interest expenses                    | \$ 11,920                          | \$ 11,527 | \$ 36,103                         | \$ 34,385 |

Total non-interest income decreased \$982,000, or 13.0%, for the third quarter of 2008, and decreased \$1,001,000, or 4.5%, for the first nine months of 2008, compared to the same periods in 2007.

Investment management and trust services income decreased \$342,000, or 10.6%, in the third quarter of 2008, as compared to the same period in 2007. This decrease arose from a decline in executor fees and the impact of a decline in the market value of assets under management, partially offset by a number of factors, none of which is individually significant. For the first nine months of 2008, investment management and trust services income decreased \$360,000, or 3.7%, compared to 2007. Trust assets under management at September 30, 2008 were \$1.46 billion, compared to \$1.67 billion at December 31, 2007 and \$1.71 billion at September 30, 2007. Trust assets are expressed in terms of market value, and total assets under management are affected directly by the performance of the equity and bond markets. As of September 30, 2008, declines in market value of trust assets more than offset 2008 growth from net new business. The year-to-date net new business totaled \$87 million or approximately twice that for the same period of 2007.

Service charges on deposit accounts decreased \$64,000, or 2.8%, in the third quarter of 2008, and \$177,000, or 2.7%, for the first nine months of 2008 as compared to the same periods in 2007. Service charge income is driven by transaction volume in deposit accounts, which can fluctuate throughout the year, and has been slowly trending downward after a high in 2006.

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Bankcard transaction revenue increased \$66,000, or 11.1%, in the third quarter of 2008, and \$246,000, or 14.2%, for the first nine months of 2008 as compared to the same periods in 2007. Results in 2008 compared favorably to 2007 as bankcard transaction volume continues to increase.

The Bank operates a mortgage banking division, which originates residential mortgage loans and sells the majority of these loans in the secondary market. Prior to late 2007, all loans were sold without retaining servicing rights. Beginning in 2007, the Bank began to service mortgage loans sold to Fannie Mae. For the third quarter and first nine months of 2008 loans sold with servicing rights retained represent approximately half of the mortgage banking division's origination and sales activity. Gains on sales of mortgage loans were \$366,000 in the third quarter of 2008 and \$227,000 in 2007. This represents an increase of 61.2%. For the nine months ended September 30, 2008, gains on the sale of mortgage loans increased 14.3% to \$999,000 from \$874,000 in 2007. Prevailing mortgage interest rates fell substantially in late 2007 and remained at attractive levels for the first nine months of 2008 helping contribute to an increase in loan volume during the first nine months of 2008.

Brokerage commissions and fees decreased \$85,000, or 17.1%, in the third quarter of 2008, and \$145,000, or 10.1%, for the first nine months of 2008, as compared to the same period in 2007. These decreases corresponded to lower overall brokerage volume. The Company expects brokerage volume to continue to be hindered until retail investor confidence in the stock market improves.

BOLI income increased \$13,000 or 5.2%, and other non-interest income decreased \$180,000, or 35.4%, in the third quarter of 2008 as compared to the same period in 2007. For the first nine months of 2008, bank owned life insurance income increased \$40,000, or 5.5%, and other non-interest income decreased 123,000, or 8.4%, as compared to the same period in 2007.

In the third quarter of 2008, the Bancorp sold \$4,125,000 par of preferred equity securities of financial companies, generating a loss of \$607,000. Due to current events in the market, and considering that these securities had no stated maturity date, management changed its intent on holding these securities, and the sale eliminated the Company's position in such securities. Management has the intent and ability to hold all remaining investment securities available for sale for the foreseeable future.

Total non-interest expenses increased \$393,000, or 3.4%, for the third quarter of 2008 as compared to the same period in 2007 and increased \$1,718,000, or 5.0%, for the first nine months of 2008 as compared to the same period in 2007.

Salaries and employee benefits decreased \$41,000, or 0.6%, for the third quarter of 2008, and increased \$1,214,000, or 6.0% for the first nine months of 2008, as compared to the same periods of 2007. These year-to-date increases reflect the addition of staff associated with the development of a second office in the Indianapolis market and the Company's recent entry into the Cincinnati market along with regular salary increases and higher stock compensation and retirement expenses. The Bank had 459 full time equivalent employees as of September 30, 2008, compared to 443 full time equivalents as of September 30, 2007.

Net occupancy expense increased \$204,000, or 22.2%, in the third quarter of 2008, and \$429,000, or 15.7% for the first nine months of 2008, as compared to the same periods of 2007, primarily reflecting costs associated with the Company's geographical expansion. Data processing expense decreased \$139,000 or 14.2% for the third quarter of 2008, and \$557,000, or 18.3% for the first nine months of 2008, as compared to the same periods in 2007, largely due to renegotiated terms with the Bank's provider of ATM network and debit card processing. Furniture and equipment expense decreased \$1,000 or 0.3% for

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the third quarter of 2008, and \$31,000 or 3.6% for the first nine months of 2008, as compared to the same periods in 2007. These fluctuations relate to a variety of factors, none of which is individually significant.

State bank taxes increased \$14,000, or 4.3%, for the third quarter of 2008, and \$179,000, or 22.0% for the first nine months of 2008, as compared to the same periods in 2007. These bank taxes are based on five-year average capital levels. The year-to-date increase is primarily because the Bancorp purchased Commonwealth of Kentucky historic tax preservation credits at a discount reducing state tax expense in the first quarter of 2007 by approximately \$160,000.

Other non-interest expenses increased \$356,000 or 16.6% in the third quarter of 2008, and \$484,000, or 7.1% for the first nine months of 2008, as compared to the same periods in 2007. The increases in other non-interest expenses are related to a variety of factors including professional fees, printing, mail and telecommunications, none of which is individually significant.

***Income Taxes***



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In the third quarter of 2008, Bancorp recorded income tax expense of \$2,776,000, compared to \$2,843,000 for the same period in 2007. The effective rate for the three month period was 33.8% in 2008 and 32.6% in 2007. Bancorp recorded income tax expense of \$7,817,000 for the first nine months of 2008, compared to \$8,617,000 for the same period in 2007. The effective rate for the nine months period was 32.0% in 2008 and 32.5% in 2007. The decrease in the effective tax rate was primarily due to an increased level of tax credits and proportion of tax-exempt interest income to total interest income.

### *Commitments*



*The Company utilizes a variety of financial instruments in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. A discussion of the Company's commitments is included in Note 6.*



*Other commitments discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, have not materially changed since that report was filed, relative to qualitative and quantitative disclosures of fixed and determinable contractual obligations.*



*b)* Financial Condition



*Balance Sheet*



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Total assets increased \$171.2 million, or 11.6%, from \$1.482 billion on December 31, 2007 to \$1.653 billion on September 30, 2008. The most significant contributor of the increase in assets was loan growth in the first half of the year. Loan totals increased \$114.7 million from the end of 2007. Also, investment securities increased \$41.2 million as a result of replacing maturing securities, as well as utilizing the investment portfolio to manage liquidity. Total assets at September 30, 2008 increased \$243 million from September 30, 2007, representing a 17.2% increase. Average assets for the first nine months of 2008 were \$1.552 billion.

Total liabilities increased \$165.4 million, or 12.3%, from \$1.349 billion on December 31, 2007 to \$1.515 billion on September 30, 2008. The most significant component of the increase was in time deposits which rose \$85.5 million, or 20.2% in support of loan growth. Total money market deposits increased \$64.0 million or 24.1%, savings deposits increased \$4.8 million or 12.5%, and other short-term borrowings increased \$4.8 million or 44.7%. Beginning late in 2007 the Bank introduced a non-collateralized corporate sweep account. These balances are included in money market deposits, and at the end of the third quarter of 2008, totaled approximately \$40.7 million. Securities sold under repurchase agreements and federal

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funds purchased decreased \$10.2 million or 9.4%. The decline in securities sold under repurchase agreements corresponds to the increase in money market deposits as discussed above, while federal funds purchased increased \$640,000 to \$28.1 million at September 30, 2008.

Holdings of trust preferred securities and a domestic private investment fund are concentrated in the bank and financial service companies, and as such, have been negatively impacted by declining industry performance. Management evaluates these investments considering various factors, and volatility in these markets, particularly subsequent to September 30 could give rise to other-than-temporary impairment in the future.

**Non-performing Loans and Assets**

Non-performing loans, which include non-accrual loans of \$3,880,000 and loans past due over 90 days and still accruing of \$60,000, totaled \$3,940,000 at September 30, 2008. Non-performing loans were \$5,481,000 at September 30, 2008 including \$543,000 of loans past due over 90 days and still accruing. Non-performing loans were \$3,370,000 at December 31, 2007 including \$406,000 of loans past due over 90 days and still accruing. Non-performing loans represents 0.30% of total loans at September 30, 2008 compared to 0.42% at June 30, 2008, and 0.28% at December 31, 2007. As noted in the Provision for Loan Losses section of this report, non-performing loans are analyzed in management's evaluation of the allowance and provision for loan losses.

Non-performing assets, which include non-performing loans, other real estate and repossessed assets, totaled \$7,122,000 at September 30, 2008 and \$7,201,000 at December 31, 2007. This represents 0.43% of total assets at September 30, 2008 compared to 0.49% at December 31, 2007.

c) Liquidity



The role of liquidity is to ensure that funds are available to meet depositors' withdrawals and borrowers' demands to fund credit commitments. This is accomplished by balancing changes in demand for funds with changes in the supply of those funds. Liquidity is provided by short-term liquid assets that can be converted to cash, investment securities available for sale, various lines of credit available to the Company, and the ability to attract funds from external sources, principally deposits. Management believes it has the ability to increase deposits at any time by offering rates slightly higher than the market rate.

The Company's most liquid assets are comprised of available for sale marketable investment securities, and federal funds sold. Federal funds sold totaled \$21.6 million at September 30, 2008. These investments normally have overnight maturities and are used for general daily liquidity purposes. The fair value of the available for sale investment portfolio was \$203.8 million at September 30, 2008, and included an unrealized net gain of \$153,000. The portfolio includes maturities of approximately \$94.6 million over the next twelve months, which offer substantial resources to meet either new loan demand or reductions in the Company's deposit funding base. The Company pledges portions of its investment securities portfolio to secure public fund deposits and securities sold under agreements to repurchase. At September 30, 2008, total investment securities pledged for these purposes comprised 47% of the available for sale investment portfolio, leaving \$109.0 million of unpledged securities.

The Company has a large base of core customer deposits, defined as demand, savings, and money market deposit accounts. At September 30, 2008, such deposits totaled \$757 million and represented 60% of the Company's total deposits. Because these core deposits are less volatile and are often tied to other products of the Company through long lasting relationships, they do not put heavy pressure on liquidity.

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**S.Y. BANCORP, INC. AND SUBSIDIARY**

With regard to credit available to the Company, the Bank is a member of the Federal Home Loan Bank of Cincinnati ( FHLB ). As a member, the Bank has access to credit products of the FHLB. As of September 30, 2008, the Bank's additional borrowing capacity with the FHLB was approximately \$21.2 million. Additionally, the Bank had an available line of credit and federal funds purchased lines with correspondent banks totaling \$112 million.

Bancorp's liquidity depends primarily on the dividends paid to it as the sole shareholder of the Bank. For the first nine months of 2008, the Bank declared dividends to Bancorp totaling \$6,856,054 to fund quarterly cash dividends to stockholders. At September 30, 2008, the Bank may pay up to \$9,612,747 in dividends to Bancorp without regulatory approval subject to the ongoing capital requirements of the Bank. In early October 2008 the Bank declared and paid a \$10 million dividend to Bancorp enabling Bancorp to reduce its debt by a corresponding amount. The Bank provided proper notice to regulators, and management does not anticipate the need to obtain Kentucky regulatory approval for dividends in the foreseeable future. Prior to the declaration of dividends, management considers the effect such payments will have on total stockholders' equity and capital ratios.

*d)* Capital Resources



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At September 30, 2008, stockholders' equity totaled \$138,910,000, an increase of \$5,886,000 since December 31, 2007. See the Consolidated Statement of Changes in Stockholders' Equity for further detail of the change in equity since the end of 2007. Some of the 2008 growth in capital was offset by share repurchase activity. During the first quarter, the Company repurchased 227,600 shares and as of September 30, 2008, the Company had remaining authorization to repurchase approximately 163,000 shares. However, management does not contemplate resuming repurchase activity in the near term, and the current repurchase plan will expire in November 2008 absent action by the Board of Directors. Accumulated other comprehensive income/(loss) which, for Bancorp, consists of net unrealized gains/(losses) on securities available for sale and a minimum pension liability adjustment, net of taxes, totaled (\$141,000) at September 30, 2008 and \$83,000 at December 31, 2007. The change since year end is a reflection of maturities within the portfolio and the effect of change in interest rates on the valuation of the Bank's portfolio of securities available for sale. The unrealized pension liability is adjusted annually by reference to updated actuarial data.

In the third quarter of 2008, the Bank issued \$10 million of subordinated debt, with a 10 year maturity, and a call option to the Bank two years after issuance. The debt carries a floating rate, which may be determined by adding a fixed spread to the prime rate or to LIBOR. At September 30, 2008 the Bank had chosen the prime rate related alternative and will reevaluate periodically to ensure the most favorable pricing. The subordinated debt qualifies as tier 2 capital. The debt may be prepaid at any time with a prepayment penalty if repaid within the first two years of the term. The only financial covenant of the debt agreement requires that the Bank remain well capitalized as defined by its primary regulator.

Bank holding companies and their subsidiary banks are required by regulators to meet risk based capital standards. These standards, or ratios, measure the relationship of capital to a combination of balance sheet and off-balance sheet risks. The values of both balance sheet and off-balance sheet items are adjusted to reflect credit risks. To be categorized as well capitalized, the Bank must maintain a total risk-based capital ratio of at least 10%; a Tier 1 ratio of at least 6%; and a leverage ratio of at least 5%.

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The following table sets forth Bancorp's risk based capital amounts and ratios as of September 30. The increase in the total risk-based capital ratio from 10.26% at June 30, 2008 to 11.26% at September 30, 2008 is largely due to the issuance of subordinated debt issued by the Bank discussed above.

|                                 | 2008       |        | September 30 |        | 2007   |       |
|---------------------------------|------------|--------|--------------|--------|--------|-------|
|                                 | Amount     | Ratio  | Amount       | Ratio  | Amount | Ratio |
| Total risk-based capital        | \$ 163,214 | 11.26% | 150,890      | 11.42% |        |       |
| For capital adequacy purposes   | 115,960    | 8.00   | 105,682      | 8.00   |        |       |
| To be well capitalized          | 144,950    | 10.00  | 132,102      | 10.00  |        |       |
| Tier 1 risk-based capital       | \$ 138,369 | 9.55%  | 138,250      | 10.47% |        |       |
| For capital adequacy purposes   | 57,956     | 4.00   | 52,841       | 4.00   |        |       |
| To be well capitalized          | 86,933     | 6.00   | 79,261       | 6.00   |        |       |
| Leverage ratio (Tier 1 capital) | \$ 138,369 | 8.40%  | 138,250      | 9.81%  |        |       |
| For capital adequacy purposes   | 49,418     | 3.00   | 42,275       | 3.00   |        |       |
| To be well capitalized          | 82,363     | 5.00   | 70,458       | 5.00   |        |       |

## e) Recently Issued Accounting Pronouncements



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In May 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 163, Accounting for Financial Guarantee Insurance Contracts - an Interpretation of FASB Statement No. 60 . This Statement prescribes the accounting for premium revenue and claims liabilities by insurers of financial obligations, and requires expanded disclosures about financial guarantee insurance contracts. This statement is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years, except for certain disclosure requirements about the risk-management activities of the insurance enterprise that are effective for the first quarter beginning after the Statement was issued. The implementation of this statement is not anticipated to have a significant impact on the Company's financial statements.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles . This Statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). Prior to SFAS No.162, the GAAP hierarchy was identified in SAS No. 69, The Meaning of Presents Fairly in Conformity with Generally Accepted Accounting Principles , and was directed at auditors. The FASB believes that the hierarchy of GAAP sources should be directed at preparers of financial statements and thus should be included within the accounting literature. This Statement is effective November 15, 2008. Any effect of applying SFAS No. 162 should be reported as a change in accounting principle. The implementation of this statement is not anticipated to have a significant impact on the Company's financial statements.

The Company adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements , on January 1, 2008. This Statement defines fair value, establishes a framework for

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measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. It emphasizes that fair value is a market-based measurement and should be determined based on assumptions that a market participant would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that provides the highest priority to measurements using quoted prices in active markets and the lowest priority to measurements based on unobservable data. The Statement does not require any new fair value measurements. The adoption of FASB Statement No. 157 did not have a material impact on Bancorp's consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. This Statement permits entities to choose to measure many financial instruments and certain other items at fair value, on an instrument-by-instrument basis. Once an entity has elected to record eligible items at fair value, the decision is irrevocable and the entity should report unrealized gains and losses for which the fair value option has been elected in earnings. The Statement's objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Statement may be applied to financial instruments existing at the January 1, 2008 adoption date, financial instruments recognized after the adoption date, and upon certain other events. As of the adoption date and subsequent to that date, the Company has chosen not to elect the fair value option, but will consider future election and the effect on its consolidated financial statements.

In December 2007 the Financial Accounting Standards Board issued a revision to Statement of Financial Accounting Standards No. 141, Business Combinations, (SFAS 141R). This statement will become effective in 2009 and sharpens the accounting guidance for business combinations and significantly expands disclosure requirements. As the Company has no business combinations underway, no impact of this pronouncement on the Company is anticipated at this time.

Statement of Financial Accounting Standards No. 160, Non-controlling Interests in Consolidated Financial Statements, must be implemented for fiscal years beginning after December 31, 2008. The objective of this statement is to improve the relevance, comparability and transparency of financial information that a reporting entity provides in its consolidated financial statements relating to an outstanding non-controlling interest in one or more subsidiaries or that deconsolidate a subsidiary. At present, these circumstances do not apply to the Company.

Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, must be implemented for fiscal years beginning after November 15, 2008. This statement amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, This statement changes the disclosure requirements for derivative instruments and hedging activities. It requires entities to discuss how and why it uses derivatives instruments, how derivative instruments and relate hedged items are accounted for under SFAS No. 133 and its related interpretations, and how derivative instruments and related hedged items affect its financial positions, financial performance and cash flows. The implementation of this statement is not anticipated to have a significant impact on the Company's financial statements.

Staff Accounting Bulletin No. 109 expresses the view of SEC staff that, for written loan commitments that are accounted for at fair value through earnings, the expected net future cash flows related to the associated servicing of those loans should be included in the measurement of fair value.



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**S.Y. BANCORP, INC. AND SUBSIDIARY**

It is to be applied prospectively to derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The implementation of this Bulletin has not had and is not anticipated to have a significant impact on the Company's financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Information required by this item is included in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 4. Controls and Procedures

Bancorp maintains disclosure controls and procedures designed to ensure that it is able to collect the information it is required to disclose in reports it files with the Securities and Exchange Commission ( SEC ), and to record, process, summarize and report this information within the time periods specified in the rules and forms of the SEC. Based on their evaluation of Bancorp's disclosure controls and procedures as of the end of the quarterly period covered by this report, the Chief Executive and Chief Financial Officers believe that these controls and procedures are effective to ensure that Bancorp is able to collect, process and disclose the information it is required to disclose in reports it files with the SEC within the required time periods.

Based on the evaluation of Bancorp's disclosure controls and procedures by the Chief Executive and Chief Financial Officers, there were no significant changes during the quarter ended September 30, 2008 in Bancorp's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, Bancorp's internal control over financial reporting.

PART II OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table shows information relating to the repurchase of shares of common stock by Bancorp during the three months ended September 30, 2008.

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|                            | <b>Total number of<br/>Shares<br/>Purchased (1)</b> | <b>Average price<br/>Paid Per Share</b> | <b>Total number of<br/>Shares Purchased as<br/>Part of Publicly<br/>Announced Plan (2)</b> | <b>Maximum Number of<br/>Shares that May Yet Be<br/>Purchased Under the<br/>Plan</b> |
|----------------------------|---|---|--|--|
| July 1 - July 31           | 2,774   | \$ 24.66                                |  | 163,000  |
| August 1 - August 31       | 1,172   | 27.02                                   |  | 163,000  |
| September 1 - September 30 | 341   | 30.79                                   |  | 163,000  |
| Total                      | 4,287   | \$ 25.79                                |  | 163,000  |

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**S.Y. BANCORP, INC. AND SUBSIDIARY**

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(1) Third quarter 2008 activity represents shares surrendered by officers, the fair value of which equaled the exercise price of stock options, and shares of stock withheld to pay taxes due upon vesting of restricted stock. This activity has no impact on the number of shares that may be purchased under the Board-approved plan.

(2) The Board of Directors of S.Y. Bancorp Inc. first approved a share buyback plan in 1999. In February 2005, the Directors of Bancorp expanded this plan to allow for the repurchase of up to 577,500 shares. The Directors expanded this plan by 550,000 additional shares in July 2007, and again in November 2007. In 2007, as part of this stock repurchase program, the Company established a Rule 10b5-1 stock trading plan. There has been no repurchase activity under this plan since March 2008. As noted above, as of September 30, 2008 there remain 163,000 shares yet to be purchased under the program. The plan's expiration date is set for November 2008.

Item 6. Exhibits

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

| <b>Exhibit number</b> | <b>Description of exhibit</b>  |
|-----------------------|--|
| 31.1                  | Certifications pursuant to Section 302 of the Sarbanes-Oxley Act by David P. Heintzman |
| 31.2                  | Certifications pursuant to Section 302 of the Sarbanes-Oxley Act by Nancy B. Davis     |
| 32                    | Certifications pursuant to 18 U.S.C. Section 1350                                      |

**SIGNATURES**



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

**S.Y. BANCORP, INC.**

Date: November 7, 2008

By: /s/ David P. Heintzman  
David P. Heintzman, Chairman  
and Chief Executive Officer

Date: November 7, 2008

By: /s/ Nancy B. Davis  
Nancy B. Davis, Executive Vice President,  
Treasurer and Chief Financial Officer