

S Y BANCORP INC  
Form 10-K  
March 13, 2009  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**Form 10-K**

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

**For the Fiscal Year Ended  
December 31, 2008**

**Commission File Number  
1-13661**

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

1040 East Main Street  
Louisville, Kentucky 40206  
(502) 582-2571

**Incorporated in Kentucky**

**I.R.S. No. 61-1137529**

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**Securities registered pursuant to Section 12(b) of the Act:**

**Title of each class:**  
Common Stock, no par value  
Preferred Share Purchase Rights  
10.00% Cumulative Trust Preferred Securities and the  
guarantee with respect thereto

**Name of each exchange on which registered:**  
NASDAQ  
NASDAQ  
NASDAQ

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**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act). **Yes**  **No**

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. **Yes**  **No**

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

The aggregate market value of registrant's voting stock (Common Stock, no par value) held by non-affiliates of the registrant as of June 30, 2008 (the last business day of the registrant's most recently completed second fiscal quarter) was \$251,227,000.

The number of shares of the registrant's Common Stock, no par value, outstanding as of March 6, 2009, was 13,530,590.

**Documents Incorporated By Reference**

**Portions of Registrant's definitive proxy statement related to Registrant's Annual Meeting of Shareholders to be held on April 22, 2009 (the Proxy Statement), are incorporated by reference into Part III of this Form 10-K.**



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**Part I**

**Item 1. Business**

S. Y. Bancorp, Inc. (Bancorp) was incorporated in 1988 and is a Kentucky corporation headquartered in Louisville, Kentucky. Bancorp is a bank holding company registered with, and subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System. Bancorp has two subsidiaries, Stock Yards Bank & Trust Company (the Bank) and S.Y. Bancorp Capital Trust II (the Trust). The Bank is wholly owned and is a state chartered bank. Bancorp conducts no active business operations; the business of Bancorp is substantially the same as that of the Bank. The operations of the Bank are fully reflected in the consolidated financial statements of Bancorp. Accordingly, references to Bancorp in this document may encompass both the holding company and the Bank. The Trust is a Delaware statutory trust that is a 100%-owned finance subsidiary of Bancorp. See Note 11 to Bancorp's consolidated financial statements for further discussion of the Trust and its accounting treatment.

**Stock Yards Bank & Trust Company**

Stock Yards Bank & Trust Company is the only banking subsidiary of Bancorp and was originally chartered in 1904. The Bank is headquartered in Louisville, Kentucky and provides commercial banking services in the Louisville Metropolitan Statistical Area (MSA), Indianapolis and Cincinnati through 28 full service banking offices (See ITEM 2. PROPERTIES ). The Bank is chartered under the laws of the Commonwealth of Kentucky. In addition to traditional commercial and personal banking activities, the Bank has an investment management and trust department offering a wide range of trust and investment services. This department operates under the name of Stock Yards Trust Company. The Bank also originates and sells single-family residential mortgages through Stock Yards Mortgage Company. Additionally, the Bank offers securities brokerage services and life insurance products through arrangements with a third party provider. See Note 22 to Bancorp's consolidated financial statements for the year ended December 31, 2008 for information relating to the Bank's business segments.

At December 31, 2008, the Bank had 464 full-time equivalent employees. Management of Bancorp strives to be an employer of choice and considers the relationship with employees to be good.

**Supervision and Regulation**

Bank holding companies and commercial banks are extensively regulated under both federal and state law. Any change in applicable law or regulation may have a material effect on the business and prospects of Bancorp and the Bank.

Bancorp, as a registered bank holding company, is subject to the supervision of and regulation by the Federal Reserve Board under the Bank Holding Company Act of 1956. In addition, Bancorp is subject to the provisions of Kentucky's banking laws regulating bank acquisitions and certain activities of controlling bank shareholders.

Kentucky and federal banking statutes delineate permissible activities for Kentucky banks. Kentucky's statutes contain a super parity provision for Kentucky banks who have received one of the two highest ratings in its most recent regulatory examination. This provision allows a state bank to engage in any banking activity in which a national bank in Kentucky, a state bank operating in any other state, or a federally chartered thrift could engage. The bank must first obtain a legal opinion specifying the statutory or regulatory provisions that permit the activity.

The Bank is subject to the supervision of and regular examination by the Federal Deposit Insurance Corporation and the Kentucky Department of Financial Institutions. The Federal Deposit Insurance Corporation insures the deposits of the Bank to the current maximums of \$250,000 per depositor for time and demand deposit accounts and self-directed retirement accounts.

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The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the 1994 Act) removed state law barriers to interstate bank acquisitions and permits the consolidation of interstate banking operations. Under the 1994 Act, adequately capitalized and managed bank holding companies may acquire banks in any state, subject to Community Reinvestment Act compliance, compliance with federal and state antitrust laws and deposit concentration limits and subject to any state laws restricting the transaction. Kentucky banks are also permitted to acquire a branch in another state if permitted by law of the other state. Kentucky currently allows out-of-state banks to enter Kentucky to provide banking services on the same terms that a Kentucky bank could enter that bank's state.

The Gramm-Leach-Bliley Act (the GLB Act) allows for affiliations among banks, securities firms and insurance companies by means of a financial holding company (FHC). In most cases, the creation of an FHC is a simple election and notice to the Federal Reserve Board. The GLB Act requires that, at the time of establishment of an FHC, all depository institutions within that corporate group must be well managed and well capitalized and must have received a rating of satisfactory or better under its most recent Community Reinvestment Act examination. Further, non-banking financial firms (for example an insurance company or securities firm) may establish an FHC and acquire a depository institution. While the distinction between banks and non-banking financial firms has been blurring over recent years, the GLB Act makes it less cumbersome for banks to offer services financial in nature but beyond traditional commercial banking activities. Likewise, non-banking financial firms may find it easier to offer services that had, heretofore, been provided primarily by depository institutions. Management of Bancorp has chosen not to become an FHC at this time, but may choose to do so in the future.

In 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (The USA Patriot Act) was signed into law. The USA Patriot Act substantially broadened the scope of U.S. anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The U.S. Treasury Department issued a number of regulations implementing the USA Patriot Act that apply certain of its requirements to financial institutions such as the Company's broker-dealer subsidiary. The regulations impose new obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing.

**Available Information**

Bancorp files reports with the SEC. Those reports include the Annual Report on Form 10-K, quarterly reports on Form 10-Q, current event reports on Form 8-K and proxy statements, as well as any amendments to those reports. The public may read and copy any materials the Registrant files with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>. Bancorp's Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act are accessible at no cost on Bancorp's web site at <http://www.syb.com> after they are electronically filed with or furnished to the SEC.

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**Item 1A. Risk Factors**

**Investments in Bancorp's common or preferred stock involve risk, and Bancorp's profitability and success may be affected by a number of factors including those discussed below.**

**Difficult national and local market conditions have adversely affected our industry.**

Declines in the housing market over the past few years, falling home prices and increasing foreclosures, unemployment and under employment have negatively impacted the credit performance of real estate related loans and resulted in significant write downs of asset values by many financial institutions. These write downs have caused many financial institutions to seek additional capital, to reduce or eliminate dividends, to merge with larger and stronger institutions and, in some cases, to fail. Reflecting concern about the stability of the financial markets, many lenders and institutional investors have reduced or ceased providing funding to borrowers, including to other financial institutions. This market turmoil and tightening of credit have led to an increased level of commercial and consumer delinquencies, lack of consumer confidence, increased market volatility and widespread reduction of business activity generally. To date, the impact of these adverse conditions has not been as severe in the primary market we serve. If current levels of market disruption and volatility continue or worsen, there can be no assurance that we will not experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

**There can be no assurance that recently enacted legislation will stabilize the U.S. financial system.**

Under the Temporary Liquidity Guarantee Program the FDIC may offer a guarantee of certain financial institution indebtedness in exchange for an insurance premium to be paid to the FDIC by issuing financial institutions. Participation in the Temporary Liquidity Guarantee Program likely will require the payment of additional insurance premiums to the FDIC. We may be required to pay higher FDIC premiums than those published for 2009 because market developments have depleted the deposit insurance fund of the FDIC and reduced the ratio of reserves to insured deposits.

There can be no assurance as to the actual impact that the EESA and its implementing regulations, the FDIC programs, or any other governmental program will have on the financial markets. The failure of the EESA, the FDIC, or the U.S. government to stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect our business, financial condition, results of operations, or access to credit.

**Our financial condition and profitability depend significantly on local and national economic conditions.**

Our success depends on general economic conditions both locally and nationally. Most of our customers are in the Louisville Metropolitan Statistical Area with a growing number of customers in the Indianapolis and Cincinnati areas. Some of our customers are directly impacted by the local economy while others have more national or global business dealings. Some of the factors influencing general economic conditions include inflation, recession and unemployment. Economic conditions can have an impact on the demand of our customers for loans, the ability



of some borrowers to repay these loans, availability of deposits and the value of the collateral securing these loans.

**Recently declining values of real estate may increase our credit losses, which would negatively affect our financial results.**

We offer a variety of secured loans, including commercial lines of credit, commercial term loans, real estate, construction, home equity, consumer and other loans. Many of our loans are secured by real estate (both residential and commercial) in our market area. Adverse changes in the local or national economy could negatively affect our customer's ability to pay these loans. If borrowers are unable to repay their loans from us and there has been deterioration in the value of the loan collateral, we could experience higher loan losses.

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Additional increases in loan loss provisions may be necessary in the future. Deterioration in the quality of our credit portfolio can have a material adverse effect on our capital, financial condition and results of operations.

**Recent unprecedented market volatility and significant stock market decline could negatively affect our financial results.**

Capital and credit markets have been experiencing volatility and disruption for more than a year and have been particularly volatile in recent months. These conditions have placed downward pressure on credit availability, credit worthiness and our customers' inclinations to borrow. A continued or worsening disruption and volatility could negatively impact our customers' ability to seek new loans or to repay existing loans. The personal wealth of many of our borrowers and guarantors has historically added a source of financial strength to those loans and has been negatively impacted by the recent severe market declines.

**If our actual loan losses are greater than our allowance assumption for loan losses, our earnings could decrease.**

Our loan customers may not repay their loans according to the terms of these loans, the collateral securing the payment of these loans may be insufficient to ensure repayment and the wealth of guarantors providing guarantees to support these loans may be insufficient to aid in the repayment of these loans. Accordingly, we may experience significant credit losses which could have a material adverse effect on operating results. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of real estate and other assets serving as collateral for repayment of many of our loans. In determining the adequacy of the allowance for loan losses, we consider, among other factors, our loan loss experience and an evaluation of economic conditions. There has been a general weakening macroeconomic trend, particularly slumping housing market conditions and widespread signs of deteriorating credit quality. If our assumptions prove to be incorrect or economic problems are much worse than projected, our current allowance may not be sufficient to cover loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in our loan portfolio. Such additions to our allowance could have a material adverse impact on our net income.

In addition, federal and state regulators periodically review our allowance for loan losses and may require an increase in our provision for loan losses or further loan charge-offs. If the regulatory agencies require any increase in our provision for loan losses or loan charge-offs for which we had not allocated, it would have a negative effect on net income.

**Fluctuations in interest rates could reduce our profitability.**

Our primary source of income is from the difference between interest earned on loans and investments and the interest paid on deposits and borrowings. We expect to periodically experience gaps in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to our position, this gap will work against us and our earnings may be negatively affected.

Many factors affect the fluctuation of market interest rates, including, but not limited to the following:

- inflation;
- recession;
- a rise in unemployment;
- tightening money supply;
- international disorder and instability in domestic and foreign financial markets;
- the Federal Reserve reducing rates; and
- competition.

Prevailing interest rates are at historically low levels, and indications are that the Federal Reserve will likely maintain the low rates for much of the upcoming year. A decrease in interest rates will decrease our net

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interest income. Our asset-liability management strategy, which is designed to mitigate our risk from changes in market interest rates, may not be able to prevent changes in interest rates from having a material adverse effect on our results of operations and financial condition. Our most recent earnings simulation model estimating the impact of changing interest rates on earnings indicates net interest income will decrease by approximately 6% if interest rates decrease 100 basis points and approximately 12% if rates decrease 200 basis points, if such a decrease is possible given current low rates. Additionally, we have observed that competitor banks are willing to pay rates on deposits well in excess of normal market rates, as liquidity has become a primary concern for many banks in light of current economic conditions.

**Declines in the securities market could affect our profitability.**

Trust assets under management are expressed in terms of market value, and a significant portion of fee income is based upon those values. Fees earned are directly affected by the performance of the equity and bond markets. Continued or sustained declines in value will result in a decrease in income from investment management and trust services.

**Competition with other financial institutions could adversely affect our profitability.**

We operate in a highly competitive industry that could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. We face vigorous competition from banks and other financial institutions. A number of these banks and other financial institutions have substantially greater resources and lending limits, larger branch systems and a wider array of banking services. Additionally, we encounter competition from both de novo and smaller community banks entering our markets. We also compete with other providers of financial services, such as brokerage firms, and credit unions. This competition may reduce or limit our margins on banking services, reduce our market share and adversely affect our results of operations and financial condition.

**We rely heavily on our management team, and the unexpected loss of key managers may adversely affect our operations.**

Our success to date has been influenced strongly by our ability to attract and to retain senior management experienced in banking and financial services. Our ability to retain executive officers and the current management teams of each of our lines of business will continue to be important to successful implementation of our strategies. There are no employment or non-compete agreements with any of these key employees, but there are non-solicitation agreements with all bank officers. The unexpected loss of services of any key management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business and financial results.

**Our accounting policies and methods are critical to how we report our financial condition and results of operations. They require management to make estimates about matters that are uncertain.**

Accounting policies and methods are fundamental to how we record and report the financial condition and results of operations. We must exercise judgment in selecting and applying many of these accounting policies and methods so they comply with Generally Accepted Accounting Principles in the United States (US GAAP).

We have identified certain accounting policies as being critical because they require management's judgment to ascertain the valuations of assets, liabilities, commitments and contingencies. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset, or reducing a liability. We have established detailed policies and control procedures that are intended to ensure these critical accounting estimates and judgments are well controlled and applied consistently. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. Because of the uncertainty surrounding our judgments and the estimates pertaining to these matters, there can be no assurances that actual results will not differ from those estimates.

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See the Critical Accounting Policies in the Management's Discussion and Analysis of Financial Condition and Results of Operations for more information.

**An extended disruption of vital infrastructure or a security breach could negatively impact our business, results of operations, and financial condition.**

Our operations depend upon, among other things, our infrastructure, including equipment and facilities. Extended disruption of vital infrastructure by fire, power loss, natural disaster, telecommunications failure, information systems breaches, terrorist activity or the domestic and foreign response to such activity, or other events outside of our control could have a material adverse impact on the financial services industry as a whole and on our business, results of operations and financial condition. Our business recovery plan may not work as intended or may not prevent significant interruption of our operations. The occurrence of any failures, interruptions, or security breaches of our information systems could damage our reputation, result in the loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have an adverse effect on our financial condition and results of operation.

**We operate in a highly regulated environment and may be adversely affected by changes in federal, state and local laws and regulations.**

We are subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal or state legislation could have a substantial impact on our bank and its operations. Additional legislation and regulations may be enacted or adopted in the future that could significantly affect our powers, authority and operations, which could have a material adverse effect on our financial condition and results of operations. Further, regulators have significant discretion and power to prevent or remedy unsafe or unsound practices or violations of laws by banks and bank holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory power may have negative impact on our results of operations and financial condition.

**Item 1B. Unresolved Staff Comments**

**Bancorp has no unresolved SEC staff comments.**

**Item 2. Properties**

The principal offices of Bancorp and the Bank are located at 1040 East Main Street, Louisville, Kentucky. The Bank's operations center is a part of the main office complex. In addition to the main office complex, the Bank owned thirteen branch properties at December 31, 2008 (two of which are located on leased land). At that date, the Bank also leased fourteen branch facilities. During the second half of 2007, the Bank opened a loan production office (LPO) in downtown Cincinnati, Ohio and in January 2008, the Bank converted the LPO to a full service branch in leased facilities. Of the twenty-eight banking locations, twenty-five are located in the Louisville MSA, two are located in Indianapolis, Indiana MSA and one is located in Cincinnati, Ohio. See Notes 5 and 17 to Bancorp's consolidated financial statements for the year ended December 31, 2008, for additional information relating to amounts invested in premises, equipment and lease commitments.

**Item 3.** Legal Proceedings

See Note 17 to Bancorp's consolidated financial statements for the year ended December 31, 2008, for information relating to legal proceedings.

**Item 4.** Submission of Matters to a Vote of Security Holders

None

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**Executive Officers of the Registrant**

The following table lists the names and ages (as of December 31, 2008) of all current executive officers of Bancorp. Each executive officer is appointed by Bancorp's Board of Directors to serve at the discretion of the Board. There is no arrangement or understanding between any executive officer of Bancorp and any other person(s) pursuant to which he/she was or is to be selected as an officer.

| <b>Name and Age of Executive Officer</b> | <b>Position and Offices with Bancorp</b>                                   |
|--|--|
| David P. Heintzman<br>Age 49             | Chairman, Chief Executive Officer, and Director                            |
| James A. Hillebrand<br>Age 40            | President and Director   |
| Kathy C. Thompson<br>Age 47              | Senior Executive Vice President and Director                               |
| Nancy B. Davis<br>Age 53                 | Executive Vice President, Secretary, Treasurer and Chief Financial Officer |

Mr. Heintzman was appointed Chairman and Chief Executive Officer effective January 1, 2006. Prior thereto, he served as President of Bancorp and the Bank since 1992. Mr. Heintzman joined the Bank in 1985.

Mr. Hillebrand was appointed President effective July 15, 2008. Prior thereto, he served as Executive Vice President and Director of Private Banking of the Bank since 2005. From 2000 to 2004, he served as Senior Vice President of Private Banking. Mr. Hillebrand joined the Bank in 1996.

Ms. Thompson was appointed Senior Executive Vice President in January 2006. Prior thereto, she served as Executive Vice President of Bancorp and the Bank. She joined the Bank in 1992 and is Manager of the Investment Management and Trust Department.

Ms. Davis was appointed Executive Vice President of Bancorp and the Bank in 1999. She joined the Bank in 1991 and was appointed Chief Financial Officer in 1993.

**Part II**

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**



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Bancorp's common stock is traded on the NASDAQ Global Select Market under the ticker symbol SYBT. Prior to July 2006, the stock traded on the American Stock Exchange under the symbol SYI. The table below sets forth the quarterly high and low market closing prices of Bancorp's common stock and dividends declared per share. The payment of dividends by the Bank to Bancorp is subject to the restriction described in Note 16 to the consolidated financial statements. Management believes that Bancorp will continue to generate adequate earnings to continue to pay dividends on a quarterly basis. On December 31, 2008, Bancorp had 1,310 shareholders of record, and approximately 2,500 non-objecting beneficial owners holding shares in nominee or street name.

| Quarter | 2008     |          |                         | 2007     |          |                         |
|---------|----------|----------|-------------------------|----------|----------|-------------------------|
|         | High     | Low      | Cash Dividends Declared | High     | Low      | Cash Dividends Declared |
| First   | \$ 25.96 | \$ 20.85 | \$ 0.17                 | \$ 28.50 | \$ 24.09 | \$ 0.15                 |
| Second  | 25.82    | 20.82    | 0.17                    | 25.70    | 23.56    | 0.16                    |
| Third   | 34.00    | 19.94    | 0.17                    | 29.31    | 22.92    | 0.16                    |
| Fourth  | 31.63    | 20.78    | 0.17                    | 28.45    | 21.68    | 0.16                    |

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The following table shows information relating to the repurchase of shares of common stock by Bancorp during the three months ended December 31, 2008.

|                        | <b>Total Number of<br/>Shares Purchased</b> | <b>Average Price Paid<br/>Per Share</b> | <b>Total Number of<br/>Shares Purchased<br/>as Part of Publicly<br/>Announced Plan</b> | <b>Maximum Number<br/>of Shares that May<br/>Yet Be Purchased<br/>Under the Plan</b> |
|------------------------|---|---|--|--|
| October 1-October 31   |   | \$                                      |  | 163,000  |
| November 1-November 30 |   |   |  |  |
| December 1-December 31 |   |   |  |  |
| <b>Total</b>           |   | \$                                      |  |  |

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. In July 2007, the Directors expanded this plan by 550,000 shares. In November 2007, the Directors expanded this plan again by 550,000 additional shares. In November 2007, as part of this stock repurchase program, the Company established a Rule 10b5-1 stock trading plan. The stock repurchase program expired in November 2008, and was not renewed. At the time of plan expiration, 163,000 shares remained to be purchased under the program.

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The following performance graph and data included shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed soliciting material or subject to Regulation 14A of the Exchange Act or incorporated by reference in any filing under the Exchange Act or the Securities Act of 1933, except as shall be expressly set forth by specific reference in such filing.

The graph compares the performance of Bancorp Common Stock to the Russell 2000 index, the SNL NASDAQ Bank index and the SNL Midwest Bank index for Bancorp's last five fiscal years. The graph assumes the value of the investment in Bancorp Common Stock and in each index was \$100 at December 31, 2003 and that all dividends were reinvested.

| Index                  | Period Ending |          |          |          |          |          |
|------------------------|---------------|----------|----------|----------|----------|----------|
|                        | 12/31/03      | 12/31/04 | 12/31/05 | 12/31/06 | 12/31/07 | 12/31/08 |
| S.Y. Bancorp, Inc.     | 100.00        | 119.25   | 126.28   | 151.62   | 132.98   | 156.99   |
| Russell 2000 Index     | 100.00        | 118.33   | 123.72   | 146.44   | 144.15   | 95.44    |
| SNL Midwest Bank Index | 100.00        | 112.84   | 108.73   | 125.68   | 97.96    | 64.44    |
| SNL NASDAQ Bank Index  | 100.00        | 114.61   | 111.12   | 124.75   | 97.94    | 71.13    |

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| (Dollars in thousands except per share data)   | Years ended December 31 |            |            |            |            |
|--|-------------------------|------------|------------|------------|------------|
|  | 2008                    | 2007       | 2006       | 2005       | 2004       |
| Net interest income                            | \$ 56,858               | \$ 53,691  | \$ 53,875  | \$ 49,235  | \$ 44,221  |
| Provision for loan losses                      | 4,050                   | 3,525      | 2,100      | 225        | 2,090      |
| Net income                                     | 21,676                  | 24,052     | 22,896     | 21,644     | 18,912     |
| <b>Per share data</b>                          |                         |            |            |            |            |
| Net income, basic                              | \$ 1.61                 | \$ 1.70    | \$ 1.58    | \$ 1.48    | \$ 1.31    |
| Net income, diluted                            | 1.59                    | 1.67       | 1.55       | 1.46       | 1.27       |
| Cash dividends declared                        | 0.68                    | 0.63       | 0.57       | 0.45       | 0.37       |
| Book value                                     | 10.72                   | 9.78       | 9.54       | 8.67       | 7.96       |
| Market value                                   | 27.50                   | 23.94      | 28.00      | 23.83      | 22.95      |
| <b>Average balances</b>                        |                         |            |            |            |            |
| Stockholders' equity                           | \$ 136,112              | \$ 139,357 | \$ 131,971 | \$ 121,614 | \$ 109,414 |
| Assets   | 1,567,967               | 1,413,614  | 1,353,651  | 1,270,178  | 1,148,652  |
| Federal Home Loan Bank advances                | 86,011                  | 65,699     | 34,466     | 25,809     | 25,573     |
| Long-term debt                                 | 3,361                   | 93         | 10,458     | 20,769     | 20,799     |
| <b>Selected ratios</b>                         |                         |            |            |            |            |
| Return on average assets                       | 1.38%                   | 1.70%      | 1.69%      | 1.70%      | 1.65%      |
| Return on average stockholders' equity         | 15.93                   | 17.26      | 17.35      | 17.80      | 17.28      |
| Average stockholders' equity to average assets | 8.68                    | 9.86       | 9.75       | 9.57       | 9.53       |
| Net interest rate spread                       | 3.51                    | 3.48       | 3.77       | 3.79       | 3.82       |
| Net interest rate margin, fully tax-equivalent | 3.93                    | 4.16       | 4.37       | 4.25       | 4.20       |
| Non-performing loans to total loans            | 0.35                    | 0.28       | 0.59       | 0.44       | 0.57       |
| Non-performing assets to total assets          | 0.39                    | 0.49       | 0.65       | 0.59       | 0.75       |
| Net charge offs to average loans               | 0.16                    | 0.20       | 0.18       | 0.07       | 0.15       |
| Allowance for loan losses to average loans     | 1.19                    | 1.16       | 1.12       | 1.19       | 1.37       |

Per share information has been adjusted to reflect 5% stock dividend effective May 2006.

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### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The purpose of this discussion is to provide information as to the analysis of the consolidated financial condition and results of operations of S.Y. Bancorp, Inc. (Bancorp) and its wholly owned subsidiary, Stock Yards Bank & Trust Company (the Bank). Bancorp, incorporated in 1988, has no active business operations. Thus, Bancorp's business is substantially the same as that of the Bank. The Bank has operated continuously since it opened in 1904. The Bank conducted business at one location for 85 years and then began branching. At December 31, 2008, the Bank had twenty-five full service banking locations in the Louisville Metropolitan Statistical Area (MSA), two full service banking locations in Indianapolis, Indiana, and one full service banking location in Cincinnati, Ohio. The Bank's focus on flexible, attentive customer service has been key to the Bank's growth and profitability. The wide range of services added by the investment management and trust department, the brokerage department, and the mortgage department helps support the corporate philosophy of capitalizing on full service customer relationships.

### **Forward-Looking Statements**

This report contains forward-looking statements under the Private Securities Litigation Reform Act that involve risks and uncertainties. These forward-looking statements may be identified by the use of words such as "expect", "anticipate", "plan", "foresee" or other words with similar meaning. 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: economic conditions both generally and more specifically in the markets in which Bancorp and its subsidiaries operate; competition for the Bank'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 the Bank's customers; or other risks detailed in Bancorp's filings with the Securities and Exchange Commission and Item 1A of this Form 10-K all of which are difficult to predict and many of which are beyond the control of Bancorp.

### **Critical Accounting Policies**

Bancorp has prepared all of the consolidated financial information in this report in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). In preparing the consolidated financial statements in accordance with U.S. GAAP, Bancorp makes estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurances that actual results will not differ from those estimates.

Management has identified the accounting policy related to the allowance and provision 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 provision for loan losses. The impact and any associated risks related to this policy on Bancorp's business operations are discussed in the "Allowance for Loan Losses" section below.

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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 IRS examinations and examinations by other state agencies, could

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materially impact Bancorp's financial position and its results from operations. Additional information regarding income taxes is discussed in the Income Taxes section below.

**Overview of 2008**

The following discussion should be read in conjunction with Bancorp's consolidated financial statements and accompanying notes and other schedules presented elsewhere in this report.

In 2008, Bancorp completed a solid year of asset and deposit growth, combined with a continuation of strong credit quality trends, which helped to offset the impact that declining interest rate environment had on our net interest margin. Net income declined 10% from 2007 marking the first time in the last 20 years that net income and earnings per share did not increase.

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

Bancorp's loan portfolio increased 12% during 2008 to \$1.35 billion, and this was the driving force for growth in interest income. Increased loan volume helped to partially offset the negative effect of increasing margin pressures the Bank has experienced. Loan growth, funded by increased deposits and increased borrowings from the Federal Home Loan Bank (FHLB), resulted in an increase in net interest income on a year to year basis. The Federal Reserve Board lowered rates seven times in 2008, totaling 4%, causing margin erosion as loans indexed to the prime rate repriced immediately with the rate changes, while we were unable to reprice many existing deposits equally, due to the absolute level of prevailing rates. The average rate earned on assets decreased in 2008 as the rates earned on loans declined. Rates paid on liabilities decreased slightly more than rates earned on assets, contributing somewhat to an improved net interest spread; however, the volume and mix of assets and liabilities resulted in a decrease in net interest margin on a year to year basis.

Distinguishing Bancorp from other similarly sized community banks is its diverse revenue stream, and non-interest income continued to be a key contributor to earnings in 2008. However, total non-interest income declined 8% from 2007 to 2008 and non-interest income as a percentage of total revenues declined to 33% in 2008 from 36% in 2007. Income from investment management and trust services, which constitutes the single largest component of non-interest income declined 5% for the year due to lower asset values and a reduction in non-recurring estate fees. Asset values are directly related to securities market performance. In addition, Bancorp experienced declines in service charges on deposit accounts and brokerage income, as well as incurring losses on sales of securities. Partially offsetting the declines were increases in revenues from bankcard transactions, gains on sales of mortgage loans, and bank owned life insurance.

Also impacting 2008 net income, Bancorp increased the 2008 loan loss provision by \$525,000 to \$4,050,000. While our non-performing loan and net-charge-off metrics remain near historic lows, we continue to be cautious about credit quality in the future because of uncertainties in the economy and the greater stress this places on borrowers. Equity-method and impairment charges totaled \$866,000 on a 2004 investment in a

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bank located in one of the Company's expansion markets. The impairment of this asset was directly attributable to the recent decline in the market value of bank stocks and reflected the impact of accounting rules with respect to measurement of fair value. From a business and strategic point of view, the Company continues to see the benefit of this investment, in terms of its ongoing expansion in this new market, and it remains a source of new business development for the Company. Equity-method charges totaled \$153,000 for an investment in a domestic private equity fund, comprised of bank and other financial industry stocks. The bank investment and the equity fund are the only such investments of their kind held by the Company. The Company also recorded impairment charges totaling \$289,000 for other real estate owned, as well as valuation losses on mortgage servicing rights totaling \$176,000. The Company continues to absorb additional costs related to its second office in Indianapolis, and in Cincinnati, a market the Company entered in the fourth quarter of 2007. Expenses for those new offices were in the start-up phase in late 2007 in terms of personnel and office space, and increased approximately \$1,000,000 from 2007 to 2008.



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In light of current pressures on the economy and uncertainties in the banking industry, S.Y. Bancorp further strengthened its balance sheet during the fourth quarter of 2008 by raising additional capital with the sale of \$30,000,000 of 10% cumulative trust preferred securities in an over-subscribed public offering. The trust preferred securities will mature on December 31, 2038, but are callable by the Company on or after December 31, 2013. This capital offering resulted in net proceeds of approximately \$28.5 million and, because the capital raised qualifies as Tier 1 capital, it helped to increase the Company's total risk-based capital ratio to 13.90% from 10.82% at December 31, 2007, both of which exceeded the 10% level required to be considered a well-capitalized institution. Separately, the Bank issued \$10 million of subordinated debentures during the third quarter of 2008, with a 10-year term and two-year call feature. These debentures qualify as Tier 2 capital for regulatory capital purposes.

As a result of its successful trust preferred offering, the Company elected not to issue preferred stock under the Treasury Department's Capital Purchase Program (CPP), even though it was approved to participate. S.Y. Bancorp already was well capitalized before the trust preferred offering, and the additional capital raised in that offering qualifies as additional Tier 1 capital. Management believes the Company remains well positioned to support the banking and lending needs of its customers today, as well as the Company's growth over the longer term, without CPP funding. Moreover, management determined that the potential dilution and uncertainty surrounding the CPP represented unnecessary burdens and risks for the Company and its shareholders.

Tangible common equity (TCE) is the book value of the Company minus the value of intangible assets, goodwill, and preferred equity. We currently have no preferred equity, our goodwill is only \$682,000, and mortgage servicing rights total \$426,000. Our TCE is \$143.4 million, or \$10.64 per share, compared with book value per share of \$10.72 based on total equity.

Challenges for 2009 will include continued net interest margin pressure, loan growth and credit quality.

- To achieve our profitability goals for 2009, net loan growth must continue at a pace similar to that of 2008. This will be impacted by competition and prevailing economic conditions. While we believe there is significant opportunity for growth in the Louisville MSA, we know that our ability to deliver attractive growth over the long-term is linked to our success in new markets, including Indianapolis and Cincinnati.
- The Federal Reserve Board lowered rates in 2008 to unprecedentedly low levels. Approximately 42% of the Bank's loans are indexed to the prime interest rate and reprice immediately with Federal Reserve rate changes. Deposit rates generally do not reprice as quickly.
- We anticipate additional pressure on net interest margin in the coming year due to the unprecedented low rate environment that now exists as well as the impact of our trust preferred securities that we recently issued to bolster capital.
- Competition from other financial institutions—both well established and newcomers—results in deposit pricing pressures. Banks facing liquidity challenges are likely to price deposits aggressively higher in order to maintain funding positions.
- Although thus far we have avoided the consequences of lending practices that have troubled other banks, we are not likely to completely escape the impact of declining real estate values and their effect on credit quality, even though our markets have fared reasonably well in the downturn so far. Clearly, the economy is in recession, the depth

and duration of which cannot be predicted.

- The personal wealth of many of our borrowers and guarantors, which historically has added a source of financial strength to their loans, has been negatively affected by severe market declines.
- In addition to scheduled increased assessment rates on FDIC insurance, in February 2009, the Board of Directors of the FDIC voted to strengthen the insurance fund by imposing a special assessment on insured institutions of 20 basis points of total deposits. The fee will be assessed on June 30 and collected on September 30, 2009. In addition, the Board may also impose an additional special assessment of up to 10 basis points after June 30, 2009. This action will significantly increase our non-interest expense.
- While we believe non-interest income will rise slightly next year, we do not expect to offset the anticipated increase in non-interest expense.

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All of these factors point toward lower net income in 2009 compared with 2008, reflecting the continuation of difficult economic conditions in our industry and across the nation.

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

**Results of Operations**

Net income was \$21,676,000 or \$1.59 per share on a diluted basis for 2008 compared to \$24,052,000 or \$1.67 per share for 2007 and \$22,896,000 or \$1.55 per share for 2006. Net income for 2008 was impacted by:

- A 5.9% increase in net interest income.
- A 14.9% increase in provision for loan losses.
- An 8.3% decrease in non-interest income.
- A 5.1% increase in non-interest expenses.
- A 1.4% increase in income taxes.

From October 2007 to March 2008, the Company repurchased a total of 639,000 common shares under its established stock repurchase plan. Since that time, however, S.Y. Bancorp has made no purchases of its common stock, choosing instead to preserve its capital in the face of uncertain economic times. While net income decreased 9.9% from 2007 to 2008, diluted earnings per share decreased 4.8% as a result of the repurchase activity.

The following paragraphs provide a more detailed analysis of the significant factors affecting operating results.

**Net Interest Income**

Net interest income, the most significant component of Bancorp's earnings, represents total interest income less total interest expense. Net interest spread is the difference between the taxable equivalent rate earned on average interest earning assets and the rate expensed on average interest bearing liabilities. Net interest margin represents net interest income on a taxable equivalent basis as a percentage of average earning assets. Net interest margin is affected by both the interest rate spread and the level of non-interest bearing sources of funds. The level of net interest income is determined by the mix and volume of interest earning assets, interest bearing deposits and interest bearing liabilities and by changes in interest rates. The discussion that follows is based on tax-equivalent interest data.

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Comparative information regarding net interest income follows:

| (Dollars in thousands)                    | 2008         | 2007         | 2006         | 2008/2007<br>Change | 2007/2006<br>Change |
|---|--------------|--------------|--------------|---------------------|---------------------|
| Net interest income, tax-equivalent basis | \$ 57,872    | \$ 54,768    | \$ 54,901    | 5.7%                | (0.2)%              |
| Net interest spread                       | 3.51%        | 3.48%        | 3.77%        | 3bp                 | (29)bp              |
| Net interest margin                       | 3.93%        | 4.16%        | 4.37%        | (23)bp              | (21)bp              |
| Average earning assets                    | \$ 1,472,098 | \$ 1,315,925 | \$ 1,256,591 | 11.9%               | 4.7%                |
| Five year treasury bond at year end       | 1.55%        | 3.45%        | 4.70%        | (190)bp             | (125)bp             |
| Average five year treasury bond           | 2.79%        | 4.42%        | 4.75%        | (163)bp             | (33)bp              |
| Prime rate at year end                    | 3.25%        | 7.25%        | 8.25%        | (400)bp             | (100)bp             |
| Average prime rate                        | 5.09%        | 8.05%        | 7.96%        | (296)bp             | 9bp                 |

bp = basis point = 1/100th of a percent

Prime rate and the five year treasury are included above to provide a general indication of the interest rate environment in which the Bank operated. Approximately 42% of the Bank's loans are variable rate and most of these loans are indexed to the Bank's prime rate and reprice as the prime rate changes. Of these variable

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rate loans, approximately \$327 million, or 24% of total loans, have reached their contractual floor of 4% or higher. Approximately \$227 million or 17% of total loans have no contractual floor. The remaining \$12 million, or 1% of total loans, of variable rate loans, have contractual floors below 4%. The Bank's variable rate loans are primarily comprised of commercial and real estate loans. Most of the Bank's fixed rate loans are priced in relation to the five year Treasury bond.

Average loan balances increased \$137 million or 11.8% in 2008; however, the declining interest rate environment drove average loan yields lower by 108 basis points. Average interest costs on interest bearing deposits decreased 109 basis points, again reflecting the declining interest rate market. Bancorp grew average interest bearing deposits \$129 million or 14.2% to fund loan growth. To supplement deposit growth, Bancorp increased its average borrowings from the FHLB by \$20.3 million with average rates being lower than comparable certificate of deposit rates. The rate decreases, combined with the volume increases, resulted in an increase in net interest income, but a decrease in net interest margin for 2008 compared to 2007.

For 2009, management anticipates a stable prime rate for the first three quarters, with a slight increase in the fourth quarter. While contractual repricing may lower some deposit costs, ever increasing competition could increase the rates paid on deposit accounts. These factors would result in compression of net interest spread and margin.

**Asset/Liability Management and Interest Rate Risk**

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. By considering both on and off-balance sheet financial instruments, 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.

**Interest Rate Simulation Sensitivity Analysis**

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 December 31, 2008 simulation analysis indicates that an increase in interest rates of 100 to 200 basis points would have a positive effect on net interest income, and a decrease of 100 to 200 basis points in interest rates would have a negative effect on net interest income. These estimates are summarized below.

|                 | <b>Net Interest<br/>Income %<br/>Change</b> |
|-----------------|---|
| Increase 200 bp | 12.39                                       |

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|                 |         |
|-----------------|---------|
| Increase 100 bp | 6.14    |
| Decrease 100 bp | (6.23)  |
| Decrease 200 bp | (12.18) |

The scenario of rates decreasing 200 bp is not likely to occur, and may not be possible given current low rates.

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The following table presents the increases in net interest income due to changes in rate and volume computed on a tax-equivalent basis and indicates how net interest income in 2008 and 2007 was impacted by volume increases and the higher average interest rate environment. The tax-equivalent adjustments are based on a 35% federal tax rate. The change in interest due to both rate and volume has been allocated to the change due to rate and the change due to volume in proportion to the relationship of the absolute dollar amounts of the change in each.

**Taxable Equivalent Rate/Volume Analysis**

| (In thousands)  | Net Change      | 2008/2007<br>Increase (Decrease)<br>Due to |                 | Net Change      | 2007/2006<br>Increase (Decrease)<br>Due to |                 |  |
|---|-----------------|--|-----------------|-----------------|--|-----------------|--|
|   |                 | Rate                                       | Volume          |                 | Rate                                       | Volume          |  |
| <b>Interest income</b>  |                 |  |                 |                 |  |                 |  |
| Loans   | \$ (4,012)      | \$ (13,347)                                | \$ 9,335        | \$ 4,826        | \$ 54                                      | \$ 4,772        |  |
| Federal funds sold  | (466)           | (703)                                      | 237             | (33)            | 88   | (121)           |  |
| Mortgage loans held for sale  | (7)             | (37)                                       | 30              | (26)            | (4)  | (22)            |  |
| <b>Securities</b>   |                 |  |                 |                 |  |                 |  |
| Taxable   | 410             | (271)                                      | 681             | 408             | 350  | 58              |  |
| Tax-exempt  | (97)            | 42   | (139)           | (210)           | 40   | (250)           |  |
| <b>Total interest income</b>  | <b>(4,172)</b>  | <b>(14,316)</b>                            | <b>10,144</b>   | <b>4,965</b>    | <b>528</b>                                 | <b>4,437</b>    |  |
| <b>Interest expense</b>   |                 |  |                 |                 |  |                 |  |
| <b>Deposits</b>   |                 |  |                 |                 |  |                 |  |
| Interest bearing demand deposits  | (2,062)         | (2,067)                                    | 5               | (169)           | 9  | (178)           |  |
| Savings deposits  | (128)           | (135)                                      | 7               | (106)           | (78)                                       | (28)            |  |
| Money market deposits   | (2,310)         | (4,973)                                    | 2,663           | 1,918           | 701  | 1,217           |  |
| Time deposits   | (2,361)         | (3,872)                                    | 1,511           | 2,254           | 2,017                                      | 237             |  |
| <b>Securities sold under agreements to repurchase and federal funds purchased</b> |                 |  |                 |                 |  |                 |  |
|   | (1,714)         | (1,507)                                    | (207)           | 574             | 377  | 197             |  |
| Other short-term borrowings   | 312             | (73)                                       | 385             | (174)           | 20   | (194)           |  |
| Federal Home Loan Bank advances   | 782             | (151)                                      | 933             | 1,734           | 272  | 1,462           |  |
| Long-term debt  | 205             | (1)  | 206             | (933)           | (131)                                      | (802)           |  |
| <b>Total interest expense</b>   | <b>(7,276)</b>  | <b>(12,779)</b>                            | <b>5,503</b>    | <b>5,098</b>    | <b>3,187</b>                               | <b>1,911</b>    |  |
| <b>Net interest income</b>  | <b>\$ 3,104</b> | <b>\$ (1,537)</b>                          | <b>\$ 4,641</b> | <b>\$ (133)</b> | <b>\$ (2,659)</b>                          | <b>\$ 2,526</b> |  |

Bancorp's net interest income increased \$3,104,000 for the year ended December 31, 2008 compared to the same period of 2007 while 2007 compared to 2006 saw a \$133,000 decrease. Net interest income for the year 2008 compared to 2007 was positively impacted by an increase in loan volume and a decrease in deposit and other borrowing rates. Net interest income was negatively impacted by a decline in the average rate earned on assets and an increase in the volume of liabilities. Loan volume increases boosted net interest income by \$9,335,000 and declining rates on deposits contributed \$11,047,000 to the increase of net interest income. Partially offsetting the increases, declining rates on loans negatively impacted net interest income by \$13,347,000, and growth in deposit balances negatively impacted the margin by \$4,186,000.

For the year 2007 compared to 2006, loan growth accounted for \$4,772,000 of the increase in interest income, which was somewhat offset by increased interest expense of \$2,718,000 due to higher rates on money market and time deposits and \$1,454,000 due to higher

money market and time deposit volume. Growth in FHLB borrowings accounted for \$1,462,000 of the increase in interest expense and an increase in average FHLB rates also increased interest expense by \$272,000.



**Table of Contents****Provision for Loan Losses**

In determining the provision for loan losses charged to expense, management considers many factors. Among these are the quality and underlying collateral of the loan portfolio, previous loss experience, the size and composition of the loan portfolio, changes in lending personnel and an assessment of the impact of current economic conditions on borrowers' ability to pay. The provision for loan losses is summarized below:

| (Dollars in thousands)              | 2008     | 2007     | 2006     |
|-------------------------------------|----------|----------|----------|
| Provision for loan losses           | \$ 4,050 | \$ 3,525 | \$ 2,100 |
| Allowance to loans at year end      | 1.14%    | 1.12%    | 1.06%    |
| Allowance to average loans for year | 1.19%    | 1.16%    | 1.12%    |

The provision for loan losses increased \$525,000 during 2008 compared to 2007 in response to Bancorp's assessment of inherent risk in the loan portfolio. Non-performing loans increased 40% from \$3,370,000 at year-end 2007 to \$4,710,000 at December 31, 2008. The ratio of non-performing loans to total loans was 0.35% at December 31, 2008, up from 0.28% at December 31, 2007. Net charge-offs totaled 0.16% of average loans at year-end 2008, down slightly from 0.20% at year-end 2007. Even though our metrics for net charge-offs and non-performing loans remain near historically low levels, management considers the volatility and disruption experienced in credit markets over the past year and the possibility that these conditions can place additional pressure on credit quality in determining the provision and allowance for loan losses. See Financial Condition-Non-performing Loans and Assets for further discussion of non-performing loans. See Financial Condition-Summary of Loan Loss Experience for further discussion of loans charged off during the year.

The Bank's loan portfolio is diversified with no significant concentrations of credit. Geographically, most loans are extended to borrowers in the Louisville, Kentucky and Indianapolis, Indiana metropolitan areas. The adequacy of the allowance is monitored on an ongoing basis and it is the opinion of management that the balance of the allowance for loan losses at December 31, 2008 is adequate to absorb losses inherent in the loan portfolio as of the financial statement date. See Financial Condition-Allowance for Loan Losses for more information on the allowance for loan losses.

**Non-Interest Income and Non-Interest Expenses**

The following table provides a comparison of the components of non-interest income for 2008, 2007 and 2006. The table shows the dollar and percentage change from 2007 to 2008 and from 2006 to 2007. Below the table is a discussion of significant changes and trends.

| (Dollars in thousands)                   | 2008      | 2007      | 2006      | 2008/2007 |        | 2007/2006 |        |
|--|-----------|-----------|-----------|-----------|--------|-----------|--------|
|  |           |           |           | Change    | %      | Change    | %      |
| <b>Non-interest income</b>               |           |           |           |           |        |           |        |
| Investment management and trust services | \$ 12,203 | \$ 12,886 | \$ 11,632 | (683)     | (5.3)% | \$ 1,254  | 10.8%  |
| Service charges on deposit accounts      | 8,350     | 8,758     | 8,791     | (408)     | (4.7)% | (33)      | (0.4)% |
| Bankcard transaction revenue             | 2,645     | 2,359     | 2,028     | 286       | 12.1%  | 331       | 16.3%  |
|  | 1,253     | 1,164     | 1,270     | 89        | 7.6%   | (106)     | (8.3)% |

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|  |           |           |           |            |        |          |        |  |
|--|-----------|-----------|-----------|------------|--------|----------|--------|--|
| Gain on sales of mortgage loans held for sale  |           |           |           |            |        |          |        |  |
| Loss on sales of securities available for sale | (607)     |           |           | (607)      |        |          |        |  |
| Brokerage commissions and fees                 | 1,797     | 1,929     | 1,973     | (132)      | (6.8)% | (44)     | (2.2)% |  |
| Bank owned life insurance income               | 1,020     | 985       | 914       | 35         | 3.6%   | 71       | 7.8%   |  |
| Other  | 1,148     | 2,251     | 2,085     | (1,103)    | -49.0% | 166      | 8.0%   |  |
|  | \$ 27,809 | \$ 30,332 | \$ 28,693 | \$ (2,523) | (8.3)% | \$ 1,639 | 5.7%   |  |

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Total non-interest income decreased 8.3% for the year ended December 31, 2008 compared to the same period for 2007. The largest component of non-interest income is investment management and trust services. Despite the volatile securities market conditions in 2008, this area of the Bank continues to grow through attraction of new business and retention of existing business. Because assets under management are expressed in terms of fair value, the impact of the market caused total assets under management to decline to \$1.3 billion in 2008 compared to \$1.7 billion at December 31, 2007. Most fees earned for managing accounts are based on a percentage of market value, resulting in a decline in investment management fees. Such decline was partially offset by the attraction of net new accounts, consisting primarily of personal accounts. Some revenues of the investment management and trust department, most notably executor fees, are non-recurring in nature and the timing of these revenues corresponds with the administration of estates. For 2008, 2007 and 2006 executor fees totaled approximately \$545,000, \$1,024,000 and \$763,000, respectively.

Service charges on deposit accounts decreased \$408,000 or 4.7%, for the year ended December 31, 2008 compared to the same period a year ago. The main factor contributing to the decrease was lower non-sufficient fund fee activity in 2008.

Bankcard transaction revenue increased \$286,000 or 12.1% in 2008 compared to 2007 and primarily represents income the Bank derives from customers' use of debit cards. The popularity of these cards has grown as customers recognize the convenience the cards offer, and there have been increases in the number of transactions by cardholders.

The Bank's mortgage banking division originates residential mortgage loans to be sold in the secondary market. Interest rates on the loans sold are locked with the buyer and investor prior to closing the loans, thus Bancorp bears no interest rate risk related to these loans. The division offers conventional, VA and FHA financing, for purchases and refinances, as well as programs for low-income first time home buyers. The mortgage banking division also offers home equity conversion mortgages or reverse mortgages insured by the U.S. Department of Housing and Urban Development (HUD). These HUD loans give older homeowners a vehicle for converting equity in their homes to cash. Interest rates on mortgage loans directly impact the volume of business transacted by the mortgage banking division. In spite of the mortgage industry's crisis, the division's loan volume held steady ending the year at 14% above the previous year. Lower rates in late 2008 contributed to a rebound in refinancing activity, boosting the volume and mortgage banking income in the fourth quarter of 2008. Prior to August of 2007, virtually all loans originated by the mortgage banking division were sold in the secondary market with servicing rights released. Beginning in 2007, the Bank began selling fixed rate conventional loans to Federal National Mortgage Association (FNMA) with servicing rights retained. Mortgage servicing rights, which are carried at the lower of cost or fair value, were written down to fair value of \$426,000 at December 31, 2008, resulting in a valuation allowance of \$176,000. A corresponding charge was included in earnings for the year 2008.

Brokerage commissions and fees earned primarily from stock, bond and mutual fund sales decreased 6.8% during 2008 as overall transaction volume was down compared to the prior year. Primarily, this was the result of a generally unfavorable economy and volatile securities market for much of 2008. Bancorp continues to offer a full complement of financial services to its customer base and feels that brokerage services are a key component of that strategy.

Income related to bank-owned life insurance ( BOLI ) increased 3.6% during 2008. BOLI generated income of \$1,020,000 and \$985,000 during 2008 and 2007, respectively. BOLI represents the cash surrender value for life insurance policies on certain key employees who have provided consent for the Bank to be the beneficiary of such policies. The related change in cash surrender value and proceeds received under the policies are recorded as non-interest income. This income helps offset the rising cost of employee benefits.

Other non-interest income decreased \$1,103,000 during 2008 compared to 2007 primarily due to a \$228,000 mark-to-market adjustment of a domestic private equity investment, an \$838,000 decline in market value of investments and life insurance policies utilized to offset

compensation expenses, partially offset by an increase in fees derived from business internet banking services. Other non-interest income increased from 2007 compared to 2006 partly as a result of an increase in fees derived from business internet banking services, combined with a variety of factors none of which are individually significant.

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The following table provides a comparison of the components of non-interest expenses for 2008, 2007 and 2006. The table shows the dollar and percentage change from 2007 to 2008 and from 2006 to 2007. Below the table is a discussion of significant changes and trends.

| (Dollars in thousands)   | 2008      | 2007      | 2006      | 2008/2007 |         | 2007/2006 |          |
|--|-----------|-----------|-----------|-----------|---------|-----------|----------|
|  |           |           |           | Change    | %       | Change    | %        |
| <b>Non-interest expense</b>  |           |           |           |           |         |           |          |
| Salaries and employee benefits   | \$ 27,686 | \$ 27,002 | \$ 26,406 | \$ 684    | 2.5%    | \$ 596    | 2.3%     |
| Net occupancy expense  | 4,247     | 3,722     | 3,480     | 525       | 14.1%   | 242       | 7.0%     |
| Data processing expense  | 3,326     | 4,043     | 3,834     | (717)     | (17.7)% | 209       | 5.5%     |
| Furniture and equipment expense  | 1,117     | 1,148     | 1,152     | (31)      | (2.7)%  | (4)       | (0.3)%   |
| Amortization and write-off of issuance costs of trust preferred securities |           |           | 897       |           |         | (897)     | (100.0)% |
| State bank taxes   | 1,334     | 1,155     | 1,298     | 179       | 15.5%   | (143)     | (11.0)%  |
| Legal and professional fees  | 1,634     | 1,394     | 1,251     | 240       | 17.2%   | 143       | 11.4%    |
| Other  | 9,541     | 8,067     | 8,292     | 1,474     | 18.3%   | (225)     | (2.7)%   |
|  | \$ 48,885 | \$ 46,531 | \$ 46,610 | \$ 2,354  | 5.1%    | \$ (79)   | (0.2)%   |

Salaries and benefits are the largest component of non-interest expenses and increased \$684,000 or 2.5% for 2008 compared to 2007. This was primarily due to a rise in personnel expense related in part to the addition of staff associated with the continued development of the Indianapolis and Cincinnati markets. The additional expense was partially offset by declines in healthcare benefits costs, pension expense, and bonuses. At December 31, 2008, the Bank had 464 full-time equivalent employees compared to 446 at the same date in 2007 and 437 for 2006. There are no obligations for post-retirement or post-employment benefits.

Additionally, Bancorp recognized \$657,000, \$467,000, and \$531,000 in stock compensation expense in 2008, 2007 and 2006, respectively, in accordance with SFAS No. 123R. See Note 15 to Bancorp's consolidated financial statements for further discussion of stock options.

Net occupancy expense has increased due to increased rent expense, increases in depreciation on buildings and leasehold improvements, and utilities. The Bank opened no new locations in 2008, three locations in 2007 and one location in 2006. At December 31, 2008 the Bank had twenty-eight banking center locations including the main office.

Data processing expense declined in 2008 largely due to renegotiated terms with the Bank's provider of ATM network and debit card processing. The increase in 2007 as compared to 2006 is due in part to a new mainframe computer and a back-up system placed into service during the year. Costs of capital asset additions flow through the statement of income over the lives of the assets in the form of depreciation expense.

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Amortization and the non-reoccurring write off of issuance costs of trust preferred securities in 2006 are related to subordinated debentures redeemed on July 1, 2006. See Note 11 for further details. These instruments bore an interest rate of 9.0% and were redeemed at par value. Unamortized issuance costs related to these instruments of \$879,000 were expensed at redemption.

State bank taxes in Kentucky are based primarily on average capital and deposit levels. Bancorp purchased Commonwealth of Kentucky historic tax preservation credits, as well as state investment tax credits, at a discount to help reduce state bank tax in 2008, 2007 and 2006. Bancorp used state historic tax credits of

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approximately \$36,000, \$195,000 and \$145,000 to help reduce state bank tax during 2008, 2007 and 2006, respectively.

Other non-interest expenses increased \$1,714,000 for the year ended December 31, 2008 compared to the same period of 2007, primarily due to valuation losses on other real estate owned of \$289,000, impairment and equity-method charges of \$866,000 for an investment in a bank located in one of the Company's expansion markets, increased FDIC insurance premiums of \$494,000, and an increase in legal and professional fees of \$240,000, partially offset by decreases in deferred compensation expenses, and a variety of factors none of which are individually significant.

**Income Taxes**

A three year comparison of income tax expense and effective tax rate follows:

| (Dollars in thousands) | 2008      | 2007     | 2006      |
|------------------------|-----------|----------|-----------|
| Income tax expense     | \$ 10,056 | \$ 9,915 | \$ 10,962 |
| Effective tax rate     | 31.7%     | 29.2%    | 32.4%     |

The reduced level of income tax expense and effective tax rate in 2007 reflected a correction to deferred tax liabilities of approximately \$648,000 recorded in the fourth quarter of 2007 and adjustments to other tax-related balances to reflect finalization of the Company's most recently filed tax returns and current tax statutes. For more information regarding income taxes and the effective tax rate see Note 7 to Bancorp's consolidated financial statements.

**Financial Condition****Earning Assets and Interest Bearing Liabilities**

Summary information with regard to Bancorp's financial condition follows:

| (Dollars in thousands)               | 2008         | 2007         | 2006         | 2008/2007<br>Change | %     | 2007/2006<br>Change | %    |
|--------------------------------------|--------------|--------------|--------------|---------------------|-------|---------------------|------|
| Average earning assets               | \$ 1,472,098 | \$ 1,315,925 | \$ 1,256,591 | \$ 156,173          | 11.9% | \$ 59,334           | 4.7% |
| Average interest bearing liabilities | 1,220,776    | 1,064,754    | 1,018,620    | 156,022             | 14.7% | 46,134              | 4.5% |
| Average total assets                 | 1,567,967    | 1,413,614    | 1,353,651    | 154,353             | 10.9% | 59,963              | 4.4% |
| Total year end assets                | 1,628,763    | 1,482,219    | 1,426,321    | 146,544             | 9.9%  | 55,898              | 3.9% |

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The Bank has experienced steady growth in earning assets over the last several years primarily in the area of loans. From 2008 to 2007, average loans increased 11.8%. More specifically, period end commercial and industrial loans increased 12.5%, construction loans increased 15.7%, owner occupied commercial real estate increased 24.5% and consumer loans increased 24.5%. The Bank has targeted commercial and industrial loans as well as private banking clientele as having attractive growth potential. Not only do these relationships afford loan growth, but they also bring opportunities to provide full-service financial relationships to business customers as well as provide personal financial services to business owners. During 2007, average loans increased 6.0% with growth being primarily from commercial and industrial loans and construction loans.

Average total interest bearing accounts increased 14.2% and non-interest bearing accounts increased 3.7%. The increase in average interest bearing liabilities from 2007 to 2008 occurred primarily in money market and time deposits spurred by promotions to support loan growth. Approximately \$30.6 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. Bancorp continued to utilize fixed rate advances from the FHLB during 2008 as they compared favorably to similar



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term time deposits. Bancorp had an average of \$86,011,000 in outstanding FHLB advances in 2008 compared to \$65,699,000 and \$34,466,000 in 2007 and 2006, respectively.

**Average Balances and Interest Rates Taxable Equivalent Basis**

| (Dollars in thousands)                       | Year 2008           |               |              | Year 2007           |               |              | Year 2006           |               |              |
|--|---------------------|---------------|--------------|---------------------|---------------|--------------|---------------------|---------------|--------------|
|  | Average Balances    | Interest      | Average Rate | Average Balances    | Interest      | Average Rate | Average Balances    | Interest      | Average Rate |
| <b>Earning assets</b>                        |                     |               |              |                     |               |              |                     |               |              |
| Federal funds sold                           | \$ 23,992           | \$ 478        | 1.99%        | \$ 18,212           | \$ 944        | 5.18%        | \$ 20,651           | \$ 977        | 4.73%        |
| Mortgage loans held for sale                 | 3,856               | 218           | 5.65%        | 3,372               | 225           | 6.67%        | 3,707               | 251           | 6.77%        |
| <b>Securities</b>                            |                     |               |              |                     |               |              |                     |               |              |
| Taxable                                      | 119,590             | 5,031         | 4.21%        | 103,747             | 4,589         | 4.42%        | 102,621             | 4,229         | 4.12%        |
| Tax-exempt                                   | 24,774              | 1,441         | 5.82%        | 27,756              | 1,538         | 5.54%        | 32,283              | 1,748         | 5.41%        |
| FHLB stock                                   | 4,175               | 216           | 5.17%        | 3,737               | 248           | 6.64%        | 3,485               | 200           | 5.74%        |
| Loans, net of unearned income                | 1,295,711           | 80,751        | 6.23%        | 1,159,101           | 84,763        | 7.31%        | 1,093,844           | 79,937        | 7.31%        |
| <b>Total earning assets</b>                  | <b>1,472,098</b>    | <b>88,135</b> | <b>5.99%</b> | <b>1,315,925</b>    | <b>92,307</b> | <b>7.01%</b> | <b>1,256,591</b>    | <b>87,342</b> | <b>6.95%</b> |
| <b>Less allowance for loan losses</b>        |                     |               |              |                     |               |              |                     |               |              |
|  | 14,600              |               |              | 12,560              |               |              | 12,406              |               |              |
|  | 1,457,498           |               |              | 1,303,365           |               |              | 1,244,185           |               |              |
| <b>Non-earning assets</b>                    |                     |               |              |                     |               |              |                     |               |              |
| Cash and due from banks                      | 27,196              |               |              | 33,305              |               |              | 34,680              |               |              |
| Premises and equipment                       | 28,101              |               |              | 25,056              |               |              | 25,063              |               |              |
| Accrued interest receivable and other assets | 55,172              |               |              | 51,888              |               |              | 49,723              |               |              |
| <b>Total assets</b>                          | <b>\$ 1,567,967</b> |               |              | <b>\$ 1,413,614</b> |               |              | <b>\$ 1,353,651</b> |               |              |

| (Dollars in thousands)  | Year 2008        |          |              | Year 2007        |          |              | Year 2006        |          |              |
|---|------------------|----------|--------------|------------------|----------|--------------|------------------|----------|--------------|
|   | Average Balances | Interest | Average Rate | Average Balances | Interest | Average Rate | Average Balances | Interest | Average Rate |
| <b>Interest bearing liabilities</b>   |                  |          |              |                  |          |              |                  |          |              |
| <b>Deposits</b>   |                  |          |              |                  |          |              |                  |          |              |
| <b>Interest bearing demand deposits</b>   |                  |          |              |                  |          |              |                  |          |              |
| deposits  | \$ 208,902       | \$ 928   | 0.44%        | \$ 208,575       | \$ 2,990 | 1.43%        | \$ 221,019       | \$ 3,159 | 1.43%        |
| Savings deposits  | 42,973           | 49       | 0.11%        | 41,388           | 177      | 0.43%        | 46,382           | 283      | 0.61%        |
| Money market deposits   | 310,466          | 5,902    | 1.90%        | 218,736          | 8,212    | 3.75%        | 185,152          | 6,294    | 3.40%        |
| Time deposits   | 477,382          | 17,653   | 3.70%        | 442,036          | 20,014   | 4.53%        | 436,288          | 17,760   | 4.07%        |
| <b>Securities sold under agreements to repurchase and federal funds purchased</b> |                  |          |              |                  |          |              |                  |          |              |
| Other short-term borrowings   | 79,582           | 1,155    | 1.45%        | 86,248           | 2,869    | 3.33%        | 79,752           | 2,295    | 2.88%        |
| FHLB advances   | 12,099           | 436      | 3.60%        | 1,979            | 124      | 6.27%        | 5,103            | 298      | 5.84%        |
|   | 86,011           | 3,928    | 4.57%        | 65,699           | 3,146    | 4.79%        | 34,466           | 1,412    | 4.10%        |

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|  |              |           |       |              |           |       |              |           |       |
|--|--------------|-----------|-------|--------------|-----------|-------|--------------|-----------|-------|
| Long-term debt                                 | 3,361        | 212       | 6.31% | 93           | 7         | 7.53% | 10,458       | 940       | 8.99% |
| Total interest bearing liabilities             | 1,220,776    | 30,263    | 2.48% | 1,064,754    | 37,539    | 3.53% | 1,018,620    | 32,441    | 3.18% |
| Non-interest bearing liabilities               |              |           |       |              |           |       |              |           |       |
| Non-interest bearing demand deposits           | 177,110      |           |       | 170,748      |           |       | 172,640      |           |       |
| Accrued interest payable and other liabilities | 33,969       |           |       | 38,755       |           |       | 30,420       |           |       |
| Total liabilities                              | 1,431,855    |           |       | 1,274,257    |           |       | 1,221,680    |           |       |
| Stockholders equity                            | 136,112      |           |       | 139,357      |           |       | 131,971      |           |       |
| Total liabilities and stockholders equity      | \$ 1,567,967 |           |       | \$ 1,413,614 |           |       | \$ 1,353,651 |           |       |
| Net interest income                            |              | \$ 57,872 |       |              | \$ 54,768 |       |              | \$ 54,901 |       |
| Net interest spread                            |              |           | 3.51% |              |           | 3.48% |              |           | 3.77% |
| Net interest margin                            |              |           | 3.93% |              |           | 4.16% |              |           | 4.37% |

Notes:

- Yields on municipal securities have been computed on a fully tax-equivalent basis using the federal income tax rate of 35%.
- The approximate tax-equivalent adjustments to interest income were \$1,014,000, \$1,077,000 and \$1,026,000 for the years ended December 31, 2008, 2007 and 2006, respectively.
- Average balances for loans include the principal balance of non-accrual loans.
- Loan interest income includes loan fees and is computed on a fully tax-equivalent basis using the federal income tax rate of 35%. Loan fees, net of deferred costs, included in interest income amounted to \$591,000, \$453,000 and \$1,039,000 in 2008, 2007 and 2006, respectively.

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The primary purpose of the securities portfolio is to provide another source of interest income, as well as liquidity management. In managing the composition of the balance sheet, Bancorp seeks a balance between earnings sources and credit and liquidity considerations.

Securities intended to be held until maturity are carried at amortized cost. Securities available for sale include securities that may be sold in response to changes in interest rates, resultant prepayment risk and other factors related to interest rate and prepayment risk changes. Securities available for sale are carried at fair value with unrealized gains or losses, net of tax effect, included in stockholders' equity.

The carrying value of securities is summarized as follows:

| (In thousands)                                       | 2008       | December 31<br>2007 | 2006       |
|--|------------|---------------------|------------|
| <b>Securities available for sale</b>                 |            |                     |            |
| U.S. Treasury and other U.S. government obligations  | \$ 6,955   | \$ 9,805            | \$ 26,618  |
| Government sponsored enterprise obligations          | 107,617    | 110,014             | 74,751     |
| Mortgage-backed securities – government agencies     | 29,263     | 11,313              | 13,801     |
| Obligations of states and political subdivisions     | 27,084     | 24,249              | 27,072     |
| Trust preferred securities of financial institutions | 2,452      | 3,217               | 1,453      |
| Other  |            | 3,951               |            |
|  | \$ 173,371 | \$ 162,549          | \$ 143,695 |
| <b>Securities held to maturity</b>                   |            |                     |            |
| Mortgage-backed securities – government              | \$ 43      | \$ 59               | \$ 89      |
| Obligations of states and political subdivisions     |            | 1,070               | 3,059      |
|  | \$ 43      | \$ 1,129            | \$ 3,148   |

Other consists of preferred securities of other bank holding companies.

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The maturity distribution and weighted average interest rates of securities at December 31, 2008, are as follows:

| (Dollars in thousands)                               | Within one year |       | After one but within five years |       | After five but within ten years |       | After ten years |       |
|--|-----------------|-------|---------------------------------|-------|---------------------------------|-------|-----------------|-------|
|  | Amount          | Rate  | Amount                          | Rate  | Amount                          | Rate  | Amount          | Rate  |
| <b>Securities available for sale</b>                 |                 |       |                                 |       |                                 |       |                 |       |
| U.S. Treasury and other U.S. government obligations  | \$ 3,814        | 2.98% | \$ 3,141                        | 4.88% |                                 |       | \$              |       |
| Government sponsored enterprise obligations          | 58,708          | 2.75% | 18,890                          | 4.70% | 27,869                          | 4.53% | 2,150           | 4.83% |
| Mortgage-backed securities                           |                 |       | 6,441                           | 3.94% | 1,724                           | 4.33% | 21,098          | 5.50% |
| Obligations of states and political subdivisions     | 2,055           | 4.00% | 11,805                          | 6.17% | 7,970                           | 6.91% | 5,254           | 6.03% |
| Trust preferred securities of financial institutions |                 |       |                                 |       |                                 |       | 2,452           | 7.96% |
|  | \$ 64,577       | 2.80% | \$ 40,277                       | 5.02% | \$ 37,563                       | 5.04% | \$ 30,954       | 5.80% |
| <b>Securities held to maturity</b>                   |                 |       |                                 |       |                                 |       |                 |       |
| Mortgage-backed securities                           | \$              |       | \$                              |       | \$ 32                           | 6.56% | \$ 11           | 6.58% |
| Obligations of states and political subdivisions     |                 |       |                                 |       |                                 |       |                 |       |
|  | \$              |       | \$                              |       | \$ 32                           | 6.56% | \$ 11           | 6.58% |

**Loan Portfolio**

Bancorp's primary source of income is interest on loans. The composition of loans as of the end of the last five years follows:

| (In thousands)               | 2008         | 2007         | December 31 2006 | 2005         | 2004       |
|------------------------------|--------------|--------------|------------------|--------------|------------|
| Commercial and industrial    | \$ 348,174   | \$ 309,506   | \$ 274,599       | \$ 225,369   | \$ 215,755 |
| Construction and development | 167,402      | 144,668      | 133,361          | 126,961      | 82,261     |
| Real estate mortgage:        |              |              |                  |              |            |
| Commercial                   | (a)          | (a)          | (a)              | (a)          | 336,382    |
| Commercial investment        | 248,308      | 240,610      | 242,742          | 219,852      | (a)        |
| Owner occupied commercial    | 249,164      | 200,122      | 178,439          | 151,651      | (a)        |
| 1-4 family residential       | 160,322      | 145,362      | 150,285          | 153,252      | 201,109    |
| Home equity                  | (b)          | 136,962      | 136,893          | 140,287      | 116,053    |
| Home equity - first lien     | 22,973       | (b)          | (b)              | (b)          | (b)        |
| Home equity - junior lien    | 122,535      | (b)          | (b)              | (b)          | (b)        |
| Consumer                     | 30,759       | 24,708       | 32,635           | 36,499       | 33,281     |
|                              | \$ 1,349,637 | \$ 1,201,938 | \$ 1,148,954     | \$ 1,053,871 | \$ 984,841 |



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(a) In 2006 the Company changed its presentation for disclosing the types of loans in its portfolio to provide more detailed information. Loans secured by commercial real estate were divided into two categories; however, it was not feasible to obtain comparable amounts for these categories for 2004.

(b) In 2008, the Company changed its presentation for disclosing the types of loans in its portfolio to provide more detailed information. Home equity lines of credit were divided into two categories - first lien and junior lien; however, it was not feasible to obtain comparable amounts for these categories for prior periods.

The following tables detail the amounts of commercial and industrial loans, and construction and development loans at December 31, 2008, which based on remaining scheduled repayments of principal, are due in the periods indicated. Also shown are the commercial and industrial loans due after one year classified according to sensitivity to changes in interest rates.

| (In thousands)               | Maturing        |                                 |                  |            | Total |
|------------------------------|-----------------|---------------------------------|------------------|------------|-------|
|                              | Within one year | After one but within five years | After five years |            |       |
| Commercial and industrial    | \$ 163,817      | \$ 131,414                      | \$ 52,943        | \$ 348,174 |       |
| Construction and development | 60,397          | 81,764                          | 25,241           | 167,402    |       |

| (In thousands)                      | Interest Sensitivity |               |
|-------------------------------------|----------------------|---------------|
|                                     | Fixed rate           | Variable rate |
| Due after one but within five years | \$ 84,636            | \$ 46,778     |
| Due after five years                | 44,811               | 8,132         |
|                                     | \$ 129,447           | \$ 54,910     |

**Non-performing Loans and Assets**

Information summarizing non-performing assets, including non-accrual loans follows:

| (Dollars in thousands)                            | 2008     | 2007     | December 31 2006 | 2005     | 2004     |
|---|----------|----------|------------------|----------|----------|
| Non-accrual loans                                 | \$ 4,455 | \$ 2,964 | \$ 5,900         | \$ 3,709 | \$ 4,944 |
| Loans past due 90 days or more and still accruing | 255      | 406      | 853              | 891      | 696      |
| Non-performing loans                              | 4,710    | 3,370    | 6,753            | 4,600    | 5,640    |
| Foreclosed real estate                            | 1,560    | 3,831    | 2,466            | 3,226    | 3,284    |
| Other foreclosed property                         | 96       |          |                  | 40       | 113      |

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|   |    |       |    |       |    |       |    |       |    |       |
|---|----|-------|----|-------|----|-------|----|-------|----|-------|
| Non-performing assets   | \$ | 6,366 | \$ | 7,201 | \$ | 9,219 | \$ | 7,866 | \$ | 9,037 |
| Non-performing loans as a percentage of total loans               |    | 0.35% |    | 0.28% |    | 0.59% |    | 0.44% |    | 0.57% |
| Non-performing assets as a percentage of total assets             |    | 0.39% |    | 0.49% |    | 0.65% |    | 0.59% |    | 0.75% |
| Allowance for loan losses as a percentage of non-performing loans |    | 327%  |    | 399%  |    | 181%  |    | 262%  |    | 222%  |

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Non-performing loans as a percentage of total loans increased 7 basis points compared to the prior year. The Bank works to aggressively respond to loan problems.

The threshold at which loans are generally transferred to non-accrual of interest status is 90 days past due unless they are well secured and in the process of collection. Interest income recorded on non-accrual loans was \$174,000, \$55,000, and \$164,000 for 2008, 2007, and 2006, respectively. Interest income that would have been recorded if non-accrual loans were on a current basis in accordance with their original terms was \$393,000, \$241,000, and \$554,000 for 2008, 2007, and 2006, respectively.

In addition to the non-performing loans discussed above, there were loans, which are accruing interest, for which payments were current or less than 90 days past due where borrowers are experiencing significant financial difficulties. These potential problem loans totaled approximately \$7,175,000, \$4,028,000, and \$5,110,000 at December 31, 2008, 2007, and 2006, respectively. These loans are monitored by management and considered in determining the level of the allowance for loan losses. Management has adequately reflected the exposure in these loans in its determination of the allowance for loan losses.

Non-performing assets as a percentage of total assets decreased 10 basis points from 2007 to 2008. The decrease in non-performing assets as a percentage of total assets was primarily the result of disposition of foreclosed assets. Remaining foreclosed real estate primarily consists of a residential subdivision development that has required several years for full disposition as the Bank has chosen to sell individual lots rather than dispose of the property in total. This asset is periodically evaluated for impairment. In December 2008, the Company recorded an impairment charge of \$289,000 based on the most recent appraisal of the property.

**Allowance for Loan Losses**

An allowance for loan losses has been established to provide for probable losses on loans that may not be fully repaid. The allowance for loan losses is increased by provisions charged to expense and decreased by charge-offs, net of recoveries. Loans are charged off by management when deemed uncollectible and typically after underlying collateral has been liquidated; however, collection efforts continue and future recoveries may occur. Management partially charges loans down to net realizable value if liquidation is inevitable but may take time.

Bancorp's lending policies and procedures center on controlling credit risk and include procedures to identify and measure this risk. These procedures begin with lenders assigning a risk rating to each of their credits, and this rating is confirmed in the loan approval process. Internal loan review, through a year-round process of examining individually significant obligor relationships as well as a sample of each lender's portfolio, tests the reliability of these risk assessments. Additionally, a review of this process is an integral part of regulatory bank examinations.

Adversely rated credits are included on a loan watch list. This list also includes loans requiring closer monitoring due to borrower's circumstances. However, these loans have generally not reached a level of adversity which would cause them to be criticized credits by regulators. Loans are added to the watch list when circumstances are detected which might affect the borrower's ability to comply with terms of the loan. This could include any of the following:



- Delinquency of a scheduled loan payment,
- Deterioration in the borrower's or guarantor's financial condition identified in a review of periodic financial statements,
- Decrease in the value of collateral securing the loan, or
- Change in the economic environment in which the borrower operates.

Loans on the watch list require detailed status reports, including recommended corrective actions, prepared by the responsible loan officer every three months. These reports are reviewed by management. The watch list is also discussed in quarterly meetings with the Board Loan Committee.

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Downgrades of loan risk ratings may be initiated by the responsible loan officer, internal loan review, or the senior loan committee at any time. Upgrades of risk ratings may only be made with the concurrence of management and internal loan review generally at the time of quarterly watch list review meetings.

In determining the allowance and related provision for loan losses, these principal elements are considered:

- Specific allocations are based upon probable losses on individually evaluated impaired loans. These estimates are based primarily upon discounted collateral exposure, but other objective factors such as payment history and financial condition of the borrower or guarantor may be used as well.
- Allocations for individually significant loans not defined as impaired based on estimates needed for pools of loans with similar risk.
- Allocations for loans not reviewed are totaled by loan category and are assigned a loss allocation factor based upon the Bank's historic net charge offs by loan type.
- Additional allowance allocations based on subjective factors not necessarily associated with a specific credit or loan category and represents management's effort to ensure that the overall allowance for loan losses appropriately reflects a margin for the imprecision necessarily inherent in the estimates of expected credit losses. Management considers a number of subjective factors, including local and general economic business factors and trends, portfolio concentrations, and changes in the size, mix and general terms of the loan portfolio.

Based on this quantitative and qualitative analysis, provisions are made to the allowance for loan losses. Such provisions are reflected as a charge against current earnings in Bancorp's consolidated statements of income.

The allocation of the allowance for loan losses by loan category is a result of the analysis above. The same procedures used to determine requirements for the allowance for loan losses establish the distribution of the allowance by loan category. The distribution of the allowance will change from period to period due to changes in the identified risk in each loan in the portfolio, changes in the aggregate loan balances by loan category, and changes in management's view of the subjective factors noted above.

The method of calculating the allowance requirements has not changed significantly over time. The reallocations among different categories of loans between periods are the result of the redistribution of the individual loans that comprise the aggregate portfolio as described above. However, the perception of risk with respect to particular loans within the portfolio will change over time as a result of the characteristics and performance of those loans, overall economic and market trends, and the actual and expected trends in non-performing loans.

The adequacy of the allowance for loan losses is monitored by the internal loan review staff and reported quarterly to the Audit and Loan Committees of the Board of Directors. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the adequacy of Bancorp's allowance for loan losses. Such agencies may require Bancorp to make additional provisions to the allowance

based upon their judgments about information available to them at the time of their examinations. Management believes that the allowance for loan losses is adequate to absorb probable inherent losses on existing loans that may become uncollectible. See Provision for Loan Losses for further discussion of the allowance for loan losses.

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The following table summarizes average loans outstanding, changes in the allowance for loan losses arising from loans charged off and recoveries on loans previously charged off by loan category and additions to the allowance charged to expense.

| (Dollars in thousands)                                    | Year ended December 31 |              |              |              |            |
|---|------------------------|--------------|--------------|--------------|------------|
|   | 2008                   | 2007         | 2006         | 2005         | 2004       |
| Average loans   | \$ 1,295,711           | \$ 1,159,101 | \$ 1,093,844 | \$ 1,015,261 | \$ 913,502 |
| Balance of allowance for loan losses at beginning of year | \$ 13,450              | \$ 12,203    | \$ 12,035    | \$ 12,521    | \$ 11,798  |
| Loans charged off   |                        |              |              |              |            |
| Commercial and industrial                                 | 341                    | 1,695        | 920          | 300          | 703        |
| Construction and development                              | 109                    | 42           | 703          |              |            |
| Real estate mortgage                                      | 1,689                  | 547          | 298          | 241          | 583        |
| Consumer  | 824                    | 827          | 853          | 822          | 793        |
| Total loans charged off                                   | 2,963                  | 3,111        | 2,774        | 1,363        | 2,079      |
| Recoveries of loans previously charged off                |                        |              |              |              |            |
| Commercial and industrial                                 | 31                     | 242          | 59           | 207          | 236        |
| Construction and development                              |                        |              | 23           |              |            |
| Real estate mortgage                                      | 236                    | 65           | 237          | 78           | 11         |
| Consumer  | 577                    | 526          | 523          | 367          | 465        |
| Total recoveries  | 844                    | 833          | 842          | 652          | 712        |
| Net loans charged off                                     | 2,119                  | 2,278        | 1,932        | 711          | 1,367      |
| Additions to allowance charged to expense                 | 4,050                  | 3,525        | 2,100        | 225          | 2,090      |
| Balance at end of year                                    | \$ 15,381              | \$ 13,450    | \$ 12,203    | \$ 12,035    | \$ 12,521  |
| Ratio of net charge-offs during year to average loans     | 0.16%                  | 0.20%        | 0.18%        | 0.07%        | 0.15%      |

See Provision for Loan Losses for discussion of the provision for loan losses.

The following table sets forth the allocation of the allowance for loan losses for the loan categories shown. Although specific allocations exist, the entire allowance is available to absorb losses in any particular loan category.

| (In thousands)               | December 31 |          |          |          |          |
|------------------------------|-------------|----------|----------|----------|----------|
|                              | 2008        | 2007     | 2006     | 2005     | 2004     |
| Commercial and industrial    | \$ 2,717    | \$ 1,991 | \$ 2,385 | \$ 3,762 | \$ 4,366 |
| Construction and development | 1,528       | 876      | 340      | 744      | 687      |

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|                      |           |           |           |           |           |
|----------------------|-----------|-----------|-----------|-----------|-----------|
| Real estate mortgage | 4,065     | 3,421     | 2,851     | 2,712     | 2,500     |
| Consumer             | 1,865     | 3,444     | 2,579     | 2,074     | 2,011     |
| Unallocated          | 5,206     | 3,718     | 4,048     | 2,743     | 2,957     |
|                      | \$ 15,381 | \$ 13,450 | \$ 12,203 | \$ 12,035 | \$ 12,521 |

The changes in the allocation of the allowance from year to year in various categories are influenced by the level of net charge-offs in the respective categories and other factors including, but not limited to, an evaluation of the impact of current economic conditions and trends, risk allocations tied to specific loans or

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groups of loans and changes in qualitative allocations. Management believes that the allocations for each loan category are reflective of the risk inherent in the portfolio.

The unallocated allowance is based upon management's evaluation of various conditions, the effects of which are not directly measured in the determination of the allocated allowance. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific credits. The conditions evaluated in connection with the unallocated allowance may include factors such as economic conditions and forecasts, the adequacy of loan policies and internal controls, the experience of the lending staff, bank regulatory examination results, and changes in the composition of the portfolio.

The ratio of loans in each category to total outstanding loans is as follows:

|                              | 2008   | 2007   | December 31<br>2006 | 2005   | 2004   |
|------------------------------|--------|--------|---------------------|--------|--------|
| Commercial and industrial    | 25.8%  | 25.8%  | 23.9%               | 21.4%  | 21.9%  |
| Construction and development | 12.4%  | 12.0%  | 11.6%               | 12.0%  | 8.3%   |
| Real estate mortgage         | 48.7%  | 48.7%  | 49.7%               | 49.8%  | 54.6%  |
| Consumer                     | 13.1%  | 13.5%  | 14.8%               | 16.8%  | 15.2%  |
|                              | 100.0% | 100.0% | 100.0%              | 100.0% | 100.0% |

Selected ratios relating to the allowance for loan losses follow:

|   | 2008  | Years ended December 31<br>2007 | 2006  |
|---|-------|---------------------------------|-------|
| Provision for loan losses to average loans  | 0.31% | 0.30%                           | 0.20% |
| Net charge-offs to average loans            | 0.16% | 0.20%                           | 0.18% |
| Allowance for loan losses to average loans  | 1.19% | 1.16%                           | 1.12% |
| Allowance for loan losses to year end loans | 1.14% | 1.12%                           | 1.06% |

**Deposits**

Bancorp's core deposits consist of non-interest and interest bearing demand deposits, savings deposits, certificates of deposit under \$100,000, certain certificates of deposit over \$100,000 and IRAs. These deposits, along with other borrowed funds, are used by Bancorp to support its asset base. By adjusting rates offered to depositors, Bancorp is able to influence the amounts of deposits needed to meet its funding requirements. The average amount of deposits in the Bank and average rates paid on such deposits for the years indicated are summarized as follows:



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| (Dollars in thousands)               | 2008            |              | Years ended December 31<br>2007 |              | 2006            |              |
|--------------------------------------|-----------------|--------------|---------------------------------|--------------|-----------------|--------------|
|                                      | Average Balance | Average Rate | Average Balance                 | Average Rate | Average Balance | Average Rate |
| Non-interest bearing demand deposits | \$ 177,110      |              | \$ 170,748                      |              | \$ 172,640      |              |
| Interest bearing demand deposits     | 208,902         | 0.44%        | 208,575                         | 1.43%        | 221,019         | 1.43%        |
| Savings deposits                     | 42,973          | 0.11%        | 41,388                          | 0.43%        | 46,382          | 0.61%        |
| Money market deposits                | 310,466         | 1.90%        | 218,736                         | 3.75%        | 185,152         | 3.40%        |
| Time deposits                        | 477,382         | 3.70%        | 442,036                         | 4.53%        | 436,288         | 4.07%        |
|                                      | \$ 1,216,833    |              | \$ 1,081,483                    |              | \$ 1,061,481    |              |

Maturities of time deposits of \$100,000 or more outstanding at December 31, 2008, are summarized as follows:

| (In thousands)           | Amount     |
|--------------------------|------------|
| 3 months or less         | \$ 26,271  |
| Over 3 through 6 months  | 40,152     |
| Over 6 through 12 months | 83,160     |
| Over 12 months           | 42,293     |
|                          | \$ 191,876 |

**Short-Term Borrowings**

Securities sold under agreements to repurchase represent short-term borrowings from commercial customers as part of a cash management service. These agreements generally have maturities of one to four days from the transaction date. Bancorp considers these core deposits since they represent excess cash balances of full relationship customers.

Information regarding securities sold under agreements to repurchase follows:

| (Dollars in thousands)                         | 2008      |       | Years ended December 31<br>2007 |       | 2006      |       |
|--|-----------|-------|---------------------------------|-------|-----------|-------|
|  | Amount    | Rate  | Amount                          | Rate  | Amount    | Rate  |
| Securities sold under agreements to repurchase |           |       |                                 |       |           |       |
| Year end                                       | \$ 61,326 | 0.29% | \$ 81,205                       | 2.79% | \$ 84,313 | 2.87% |
| Average during year                            | 65,824    | 1.28% | 83,775                          | 3.27% | 78,028    | 2.82% |
| Maximum month end balance during year          | 73,988    |       | 95,295                          |       | 84,313    |       |



**Subordinated Debentures**

Subordinated debentures are classified as long term debt. In light of current pressures on the economy and uncertainties in the banking industry, S.Y. Bancorp further strengthened its balance sheet during the fourth quarter of 2008 by raising additional capital with the sale of \$30,000,000 of 10% cumulative trust preferred

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securities in an over-subscribed public offering. The trust preferred securities will mature on December 31, 2038, but are callable by the Company on or after December 31, 2013. This offering resulted in net proceeds of approximately \$28.5 million and helped to increase the Company's total risk-based capital ratio to 13.90% from 10.82% at December 31, 2007.

As a result of its successful trust preferred offering, the Company elected not to issue preferred stock under the Treasury Department's Capital Purchase Program (CPP), even though it was approved to participate. S.Y. Bancorp already was well capitalized before the trust preferred offering, and the additional capital raised in that offering qualifies as additional Tier 1 capital. Management believes the Company remains well positioned to support the banking and lending needs of its customers today, as well as the Company's growth over the longer term, without CPP funding. Had the Company not raised additional capital it may not have compared favorably to peer banks who participated in the CPP. Moreover, management determined that the potential dilution and uncertainty surrounding the CPP represented unnecessary burdens and risks for the Company and its shareholders.

On September 30, 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. The Bank utilized the funds to pay a dividend to the Company, in order to reduce a line of credit with a correspondent bank.

In June 2001, Bancorp issued \$20 million in trust preferred securities to provide capital needed to support rapid growth. Given the interest rate environment at the time and that Bancorp no longer needed the regulatory capital provided by these securities to remain well-capitalized; Bancorp redeemed the securities on July 1, 2006, at par. See Note 11 for further information regarding subordinated debentures.

**Liquidity**

The role of liquidity management is to ensure funds are available to meet depositors' withdrawal and borrowers' credit demands while at the same time maximizing profitability. 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.

Bancorp's Asset/Liability Committee is primarily made up of senior management and has direct oversight responsibility for Bancorp's liquidity position and profile. A combination of daily, weekly and monthly reports provided to management detail the following: internal liquidity metrics, composition and level of the liquid asset portfolio, timing differences in short-term cash flow obligations, and exposure to contingent draws on Bancorp's liquidity.

The Company's most liquid assets are comprised of federal funds sold and available for sale marketable investment securities. Federal funds sold totaled \$2.3 million at December 31, 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 \$173.4 million at December 31, 2008, and included an unrealized net

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gain of \$3.9 million. The portfolio includes maturities of approximately \$65.3 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 December 31, 2008, total investment securities pledged for these purposes comprised 55% of the available for sale investment portfolio, leaving \$77.2 million of unpledged securities.

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The Company has a large base of core customer deposits, defined as demand, savings, and money market deposit accounts. At December 31, 2008, such deposits totaled \$776 million and represented 61% 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.

Other sources of funds available to meet daily needs include the sales of securities under agreements to repurchase and funds made available under a treasury tax and loan note agreement with the federal government. Also, the Bank is a member of the FHLB of Cincinnati. As a member of the FHLB, the Bank has access to credit products of the FHLB. The Bank views these borrowings as a low cost alternative to certificates of deposit and uses the standby letters of credit to back certain investment management and trust deposits retained as deposits in the Bank. At December 31, 2008, the amount of available credit from the FHLB totaled \$111 million. Bancorp's ability to borrow from the FHLB has increased due to the updating of collateral requirements by the FHLB. See Note 10 for further information regarding advances from the Federal Home Loan Bank. Also, the Bank has available federal funds purchased lines with correspondent banks totaling \$150 million. Bancorp can also borrow from the Federal Reserve Bank of St. Louis based upon its asset size. Additionally, Bancorp has a line of credit of \$20 million with a correspondent bank. Management believes it has the ability to establish additional lines of credit with outside banks.

Bancorp's liquidity depends primarily on the dividends paid to it as the sole shareholder of the Bank. As discussed in Note 16 to Bancorp's consolidated financial statements, as of January 1 of any year the Bank may pay up to the Bank's net income of the prior two years less any dividends paid for the same two years. As a result of a \$20 million dividend in 2006 to fund redemption of trust preferred securities, the Bank needed and obtained approval for its first quarter 2007 and 2008 dividends. In addition, the Bank needed and obtained approval for a \$10,000,000 special dividend in the fourth quarter of 2008 to fund a principal reduction of an outstanding line of credit. Prior to the declaration of dividends, management considers the effect such payments will have on total stockholders' equity and capital ratios.

Over the normal course of business, Bancorp enters into certain forms of off-balance sheet transactions, including unfunded loan commitments and letters of credit. These transactions are managed through Bancorp's various risk management processes. Management considers both on-balance sheet and off-balance sheet transactions in its evaluation of Bancorp's liquidity.

**Sources and Uses of Cash**

Bancorp derives most of its cash flow from the activities of the Bank. Cash flow is provided primarily through the financing activities of the Bank which include raising deposits and the borrowing of funds from institutional sources such as advances from FHLB and fed funds purchased. These funds are then primarily used to facilitate the investment activities of the Bank which include making loans and purchasing securities for the investment portfolio. Another important source of cash is from the net income of the Bank from operating activities. A portion of the net income from the Bank is also used to pay dividends to shareholders.

In 2008, the Bancorp issued \$30,000,000 of 10% cumulative trust preferred securities, resulting in net proceeds of approximately \$28.5 million, used primarily to fund loan growth. In addition, in 2008, the Bank issued \$10 million of subordinated debt. The Bank utilized the funds to pay a dividend to the Company, in order to reduce a line of credit with a correspondent bank.

For more specific information, see the consolidated statement of cash flows in Bancorp's consolidated financial statements.

**Commitments**

In the normal course of business, Bancorp is party to activities that contain credit, market and operational risk that are not reflected in whole or in part in Bancorp's consolidated financial statements. Such activities include: traditional off-balance sheet credit-related financial instruments, commitments under operating leases and long-term debt.

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The Bank provides customers with off-balance sheet credit support through loan commitments and standby letters of credit. Summarized credit-related financial instruments, including both commitments to extend credit and letters of credit at December 31, 2008 are as follows:

| (In thousands)            | Total      | Amount of Commitment Expiration per Period |           |           | Over 5 Years |
|---------------------------|------------|--|-----------|-----------|--------------|
|                           |            | Less than 1 year                           | 1-3 Years | 3-5 Years |              |
| Unused loan commitments   | \$ 314,478 | \$ 164,149                                 | \$ 49,206 | \$ 37,657 | \$ 63,466    |
| Standby letters of credit | 21,869     | 11,418                                     | 10,372    | 79        | 0            |

Since some of the unused commitments are expected to expire or may not be fully used, the total amount of commitments in the preceding table does not necessarily represent future cash requirements.

In addition to owned banking facilities, the Bank has entered into long-term leasing arrangements to support the ongoing activities of Bancorp. The Bank also has required future payments for a defined benefit retirement plan, long-term debt and the maturity of time deposits. See Note 8, Note 10, Note 11 and Note 14 to Bancorp's consolidated financial statements for further information on time deposits, Federal Home Loan Bank advances, subordinated debentures and the defined benefit retirement plan.

The required payments under such commitments at December 31, 2008 are as follows:

| (In thousands)                  | Total     | Payments due by period |           |           | Over 5 Years |
|---------------------------------|-----------|------------------------|-----------|-----------|--------------|
|                                 |           | Less than 1 year       | 1-3 Years | 3-5 Years |              |
| Operating leases                | \$ 11,058 | \$ 1,548               | \$ 2,886  | \$ 2,414  | \$ 4,210     |
| Defined benefit retirement plan | 4,563     | 174                    | 276       | 246       | 3,867        |
| Federal Home Loan Bank advances | 70,000    | 30,000                 | 20,000    | 20,000    |              |
| Subordinated debentures         | 10,060    |                        |           |           | 10,060       |
| Trust preferred securities      | 30,900    |                        |           |           | 30,900       |
| Time deposits                   | 495,102   | 370,937                | 101,363   | 20,870    | 1,932        |

## Capital

Information pertaining to Bancorp's capital balances and ratios follows:

| (Dollars in thousands, except share data) | Years ended December 31 |            |            |
|---|-------------------------|------------|------------|
|   | 2008                    | 2007       | 2006       |
| Stockholders' equity                      | \$ 144,500              | \$ 133,024 | \$ 137,444 |
| Dividends per share                       | \$ 0.68                 | \$ 0.63    | \$ 0.57    |

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|                           |        |        |        |
|---------------------------|--------|--------|--------|
| Tier 1 risk-based capital | 12.11% | 9.82%  | 10.81% |
| Total risk-based capital  | 13.90% | 10.82% | 11.77% |
| Leverage ratio            | 10.62% | 9.21%  | 10.18% |

The increase in stockholders' equity from 2007 to 2008 was primarily due to the growth in retained earnings from 2008, net of the effect of Bancorp's stock repurchase activities and an increase in dividend payouts. The Board of Directors of Bancorp first approved a share buyback plan in 1999 and in February 2006, July 2007 and November 2007, the Directors expanded this plan to provide additional shares for repurchase. The plan expired in November 2008 with 163,000 shares yet to be purchased under the program. From October 2007 to March 2008, the Company repurchased a total of 639,000 common shares under its established stock repurchase plan. Since that time, however, S.Y. Bancorp has made no purchases of its common stock, choosing instead to preserve its capital in the face of uncertain economic times. S.Y. Bancorp also increased its cash payout to stockholders during 2008, raising the annual dividend 7.9% to \$0.68 per share, or an annual

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yield of 2.47% when annualizing the fourth quarter dividend rate and considering the year-end closing stock price.

S.Y. Bancorp further strengthened its balance sheet during the fourth quarter of 2008 by raising additional capital with the sale of \$30,000,000 of trust preferred securities. As a result of its successful trust preferred offering, the Company elected not to issue preferred stock under the Treasury Department's Capital Purchase Program (CPP), even though it was approved to participate. S.Y. Bancorp already was well capitalized before the trust preferred offering, and the additional capital raised in that offering qualifies as additional Tier 1 capital. Separately, the Company also issued \$10 million of subordinated debentures during the third quarter of 2008. These debentures qualify as Tier 2 capital for regulatory capital purposes.

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 value of both balance sheet and off-balance sheet items are adjusted to reflect credit risks. The increase in capital ratios from 2007 to 2008 resulted largely from the issuance of trust preferred securities. See Note 11 for more detail regarding subordinated debentures. Note 20 to the consolidated financial statements provides more details of regulatory capital requirements, as well as capital ratios of Bancorp and the Bank. Bancorp and the Bank exceed regulatory capital ratios required to be well capitalized. Management considers the effects of growth on capital ratios as it contemplates plans for expansion.

One component of equity is accumulated other comprehensive income (loss) which, for Bancorp, consists of net unrealized gains or losses on securities available for sale and a minimum pension liability, both net of taxes. Accumulated other comprehensive income was \$2,290,000 and \$83,000 at December 31, 2008 and 2007, respectively. The \$2,207,000 change is primarily a reflection of the effect of the changing interest rate environment during fiscal year 2008 on the valuation of the Bank's portfolio of securities available for sale.

The following table presents various key financial ratios:

|  | Years ended December 31 |        |        |
|--|-------------------------|--------|--------|
|  | 2008                    | 2007   | 2006   |
| Return on average assets                       | 1.38%                   | 1.70%  | 1.69%  |
| Return on average stockholders' equity         | 15.93%                  | 17.26% | 17.35% |
| Dividend pay out ratio, based on basic EPS     | 42.24%                  | 37.06% | 36.08% |
| Average stockholders' equity to average assets | 8.68%                   | 9.86%  | 9.75%  |

**Fair Value Measurements**

Effective January 1, 2008 the Company adopted FASB Statement No. 157, Fair Value Measurements. This statement is definitional and disclosure oriented and addresses how companies should approach measuring fair value when required by Generally Accepted Accounting Principles (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. SFAS 157, which requires fair value measurements to be classified as Level 1 (quoted prices), Level 2 (based on observable inputs) or Level 3 (based on unobservable, internally-derived inputs), is discussed in more detail in Note 18 to the consolidated financial statements.

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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 and impaired loans may be recorded at fair value on a non-recurring basis, generally in the application of lower of cost or market adjustments or write-downs of specific assets.

The portfolio of investment securities available for sale is comprised of debt securities of the U.S. Treasury and other U.S. government-sponsored corporations, mortgage-backed securities, obligations of state and political subdivisions, and trust preferred securities of other banks. The trust preferred securities are priced using quoted prices of identical securities in an active market. These measurements are classified as Level 1. 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.

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

|  | Total      | Fair value at December 31, 2008 |            |         |
|--|------------|---------------------------------|------------|---------|
|  |            | Level 1                         | Level 2    | Level 3 |
| Investment securities available for sale | \$ 173,371 | \$ 1,072                        | \$ 172,299 | \$      |

Mortgage loans held for sale are carried at the lower of cost or market value. The portfolio is comprised of residential real estate loans and fair value is based on specific prices of underlying contracts for sales to investors. These measurements are classified as Level 2.

Mortgage servicing rights (MSRs) are recorded at fair value upon capitalization, are amortized to correspond with estimated servicing income, and are periodically assessed for impairment based on fair value at the reporting date. Fair value is based on a valuation model that calculates the present value of estimated net servicing income. The model incorporates assumptions that market participants would use in estimating future net servicing income. These measurements are classified as Level 3.

The Company's investment in a domestic private equity fund is comprised of bank and other financial industry stocks, and this investment is recorded at fair value using the equity method of accounting. Individual securities contained in the fund are priced using quoted prices of identical securities, quoted prices of similar securities and market-based models. These assumptions are generally observable in the market place and can be derived from or supported by observable data. These measurements are classified as Level 2.

The Company's investment in a bank in one of the Company's expansion markets is recorded at cost adjusted for our proportionate share of that bank's losses to date. As of December 31, 2008, the Company evaluated this investment for impairment based on a quoted price for this security in a market that is generally not active. Therefore, the measurement was classified as Level 2.

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

|  | Total    | Fair value at December 31, 2008 |          |         |
|--|----------|---------------------------------|----------|---------|
|  |          | Level 1                         | Level 2  | Level 3 |
| Mortgage loans held for sale               | \$ 2,950 | \$                              | \$ 2,950 | \$      |
| Mortgage servicing rights                  | 426      |                                 |          | 426     |
| Investment in domestic private equity fund | 1,776    |                                 | 1,776    |         |
| Investment in bank in expansion market     | 520      |                                 | 520      |         |
| Total                                      | \$ 5,672 | \$                              | \$ 5,246 | \$ 426  |

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 \$426,000 at December 31, 2008, resulting in a valuation allowance of \$176,000. A corresponding charge of \$176,000 was included in earnings for the year 2008.

The investment in a bank located in one of the Company's expansion markets, which is recorded using the equity method of accounting, was written down to \$520,000 at December 31, 2008. An impairment charge of \$406,000 was included in earnings for the year 2008.

Loans are measured for impairment and, if indicated, are written down based on the value of underlying collateral. At December 31, 2008, the carrying value of impaired loans with a valuation allowance was \$2,724,000 and the corresponding valuation allowance was \$1,255,000. See Note 4 for additional information regarding impaired loans.

**Recently Issued Accounting Pronouncements**

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 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

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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.

In December 2007 the FASB 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.

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Statement of Financial Accounting Standards No. 160, Non-controlling Interests in Consolidated Financial Statements, issued in December 2007, 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, issued in March 2008, 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.

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 any 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 any impact on the Company's financial statements.

Staff Accounting Bulletin No. 109 Written Loan Commitments Recorded at Fair Value through Earnings, issued in November 2007, 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. 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 any impact on the Company's financial statements.

Staff Accounting Bulletin No. 110 Share Based Payment, issued in December 2007, states that the SEC will continue to accept the simplified method for estimating the expected return of a plain vanilla share option grant under specified conditions. Under the simplified method, the expected term used to value a share option grant is the mid-point between the vesting date and the contractual term of the share option. The new guidance eliminates the December 31, 2007 sunset provision for use of the simplified method in SAB 107, Share-Based Payment. The implementation of this Bulletin has not had and is not anticipated to have any impact on the Company's financial statements.



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**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Information required by this item is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K.

**Item 8. Financial Statements and Supplementary Data**

The following consolidated financial statements of Bancorp and report of independent auditors are included below:

Consolidated Balance Sheets - December 31, 2008 and 2007

Consolidated Statements of Income - years ended December 31, 2008, 2007 and 2006

Consolidated Statements of Changes in Stockholders' Equity - years ended December 31, 2008, 2007 and 2006

Consolidated Statements of Comprehensive Income - years ended December 31, 2008, 2007 and 2006

Consolidated Statements of Cash Flows - years ended December 31, 2008, 2007 and 2006

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

Management's Report on Consolidated Financial Statements

Table of Contents**Consolidated Balance Sheets**

| (Dollars in thousands)  | December 31,        |                     |
|---|---------------------|---------------------|
|   | 2008                | 2007                |
| <b>Assets</b>   |                     |                     |
| Cash and due from banks   | \$ 24,859           | \$ 38,907           |
| Federal funds sold  | 2,254               | 422                 |
| Mortgage loans held for sale  | 2,950               | 4,771               |
| Securities available for sale (amortized cost \$169,505 in 2008 and \$161,927 in 2007)  | 173,371             | 162,549             |
| Securities held to maturity (fair value \$44 in 2008 and \$1,128 in 2007)   | 43                  | 1,129               |
| Federal Home Loan Bank stock  | 4,324               | 3,931               |
| Loans   | 1,349,637           | 1,201,938           |
| Less allowance for loan losses  | 15,381              | 13,450              |
| Net loans   | 1,334,256           | 1,188,488           |
| Premises and equipment  | 27,926              | 27,195              |
| Bank owned life insurance   | 24,142              | 23,122              |
| Accrued interest receivable   | 5,955               | 6,516               |
| Other assets  | 28,683              | 25,189              |
| <b>Total assets</b>   | <b>\$ 1,628,763</b> | <b>\$ 1,482,219</b> |
| <b>Liabilities</b>  |                     |                     |
| Deposits  |                     |                     |
| Non-interest bearing  | \$ 182,778          | \$ 170,477          |
| Interest bearing  | 1,088,147           | 936,230             |
| Total deposits  | 1,270,925           | 1,106,707           |
| Securities sold under agreements to repurchase and federal funds purchased  | 66,517              | 108,699             |
| Other short-term borrowings   | 1,132               | 10,665              |
| Accrued interest payable  | 690                 | 1,092               |
| Other liabilities   | 34,039              | 31,942              |
| Federal Home Loan Bank advances   | 70,000              | 90,000              |
| Subordinated debentures   | 40,960              | 90                  |
| <b>Total liabilities</b>  | <b>1,484,263</b>    | <b>1,349,195</b>    |
| <b>Stockholders equity</b>  |                     |                     |
| Preferred stock, no par value; 1,000,000 shares authorized; no shares issued or outstanding   |                     |                     |
| Common stock, no par value; 20,000,000 shares authorized; issued and outstanding<br>13,473,740 shares in 2008 and 13,599,563 shares in 2007 | 5,802               | 6,214               |
| Additional paid-in capital  | 7,485               | 9,821               |
| Retained earnings   | 128,923             | 116,906             |
| Accumulated other comprehensive income  | 2,290               | 83                  |
| <b>Total stockholders equity</b>  | <b>144,500</b>      | <b>133,024</b>      |
| <b>Total liabilities and stockholders equity</b>  | <b>\$ 1,628,763</b> | <b>\$ 1,482,219</b> |

See accompanying notes to consolidated financial statements.





**Table of Contents****Consolidated Statements of Income**

| (In thousands, except per share data)                                      | Years Ended December 31, |               |               |
|--|--------------------------|---------------|---------------|
|  | 2008                     | 2007          | 2006          |
| <b>Interest income</b>   |                          |               |               |
| Loans  | \$ 80,171                | \$ 84,149     | \$ 79,437     |
| Federal funds sold   | 478                      | 944           | 977           |
| Mortgage loans held for sale   | 218                      | 225           | 251           |
| <b>Securities</b>  |                          |               |               |
| Taxable  | 5,247                    | 4,837         | 4,429         |
| Tax-exempt   | 1,007                    | 1,075         | 1,222         |
| <b>Total interest income</b>   | <b>87,121</b>            | <b>91,230</b> | <b>86,316</b> |
| <b>Interest expense</b>  |                          |               |               |
| Deposits   | 24,532                   | 31,393        | 27,496        |
| Securities sold under agreements to repurchase and federal funds purchased | 1,155                    | 2,869         | 2,295         |
| Other short-term borrowings  | 436                      | 124           | 298           |
| Federal Home Loan Bank advances  | 3,928                    | 3,146         | 1,412         |
| Subordinated debentures  | 212                      | 7             | 940           |
| <b>Total interest expense</b>  | <b>30,263</b>            | <b>37,539</b> | <b>32,441</b> |
| <b>Net interest income</b>   | <b>56,858</b>            | <b>53,691</b> | <b>53,875</b> |
| Provision for loan losses  | 4,050                    | 3,525         | 2,100         |
| <b>Net interest income after provision for loan losses</b>                 | <b>52,808</b>            | <b>50,166</b> | <b>51,775</b> |
| <b>Non-interest income</b>   |                          |               |               |
| Investment management and trust services                                   | 12,203                   | 12,886        | 11,632        |
| Service charges on deposit accounts  | 8,350                    | 8,758         | 8,791         |
| Bankcard transaction revenue   | 2,645                    | 2,359         | 2,028         |
| Gain on sales of mortgage loans held for sale                              | 1,253                    | 1,164         | 1,270         |
| Loss on sales of securities available for sale                             | (607)                    |               |               |
| Brokerage commissions and fees   | 1,797                    | 1,929         | 1,973         |
| Bank owned life insurance income   | 1,020                    | 985           | 914           |
| Other  | 1,148                    | 2,251         | 2,085         |
| <b>Total non-interest income</b>   | <b>27,809</b>            | <b>30,332</b> | <b>28,693</b> |
| <b>Non-interest expense</b>  |                          |               |               |
| Salaries and employee benefits   | 27,686                   | 27,002        | 26,406        |
| Net occupancy expense  | 4,247                    | 3,722         | 3,480         |
| Data processing expense  | 3,326                    | 4,043         | 3,834         |
| Furniture and equipment expense  | 1,117                    | 1,148         | 1,152         |
| Amortization and write-off of issuance costs of trust preferred securities |                          |               | 897           |
| State bank taxes   | 1,334                    | 1,155         | 1,298         |
| Legal and professional fees  | 1,634                    | 1,394         | 1,251         |
| Other  | 9,541                    | 8,067         | 8,292         |
| <b>Total non-interest expense</b>  | <b>48,885</b>            | <b>46,531</b> | <b>46,610</b> |
| <b>Income before income taxes</b>  | <b>31,732</b>            | <b>33,967</b> | <b>33,858</b> |
| Income tax expense   | 10,056                   | 9,915         | 10,962        |

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|                                      |    |        |    |        |    |        |
|--------------------------------------|----|--------|----|--------|----|--------|
| <b>Net income</b>                    | \$ | 21,676 | \$ | 24,052 | \$ | 22,896 |
| <b>Net income per share, basic</b>   | \$ | 1.61   | \$ | 1.70   | \$ | 1.58   |
| <b>Net income per share, diluted</b> | \$ | 1.59   | \$ | 1.67   | \$ | 1.55   |

See accompanying notes to consolidated financial statements.

**Table of Contents****Consolidated Statements of Changes in Stockholders' Equity**

| (In thousands, except per share data)                                | Common Stock     |          | Three Years Ended December 31, 2008 |                   |            | Accumulated Other Comprehensive Income (Loss) | Total |
|--|------------------|----------|-------------------------------------|-------------------|------------|---|-------|
|  | Number of Shares | Amount   | Additional Paid-in Capital          | Retained Earnings |            |   |       |
| Balance December 31, 2005  | 13,816           | \$ 6,931 | \$ 14,773                           | \$ 105,290        | \$ (1,197) | \$ 125,797                                    |       |
| Net income   |                  |          |                                     | 22,896            |            | 22,896  |       |
| Change in other comprehensive loss, net of tax                       |                  |          |                                     |                   | 184        | 184   |       |
| Stock compensation expense   |                  |          | 531                                 |                   |            | 531   |       |
| 5% stock dividend  | 690              | 2,301    | 15,694                              | (17,995)          |            |   |       |
| Shares issued for stock options exercised and employee benefit plans | 101              | 321      | 1,301                               |                   |            | 1,622   |       |
| Cash dividends, \$0.57 per share                                     |                  |          |                                     | (8,315)           |            | (8,315)                                       |       |
| Shares repurchased or cancelled                                      | (207)            | (675)    | (4,596)                             |                   |            | (5,271)                                       |       |
| Balance December 31, 2006  | 14,400           | \$ 8,878 | \$ 27,703                           | \$ 101,876        | \$ (1,013) | \$ 137,444                                    |       |
| Net income   |                  |          |                                     | 24,052            |            | 24,052  |       |
| Change in other comprehensive income, net of tax                     |                  |          |                                     |                   | 1,096      | 1,096   |       |
| Stock compensation expense   |                  |          | 467                                 |                   |            | 467   |       |
| Shares issued for stock options exercised and employee benefit plans | 82               | 277      | 969                                 |                   |            | 1,246   |       |
| Shares issued for non-vested restricted stock                        | 4                | 14       | 96                                  | (110)             |            |   |       |
| Cash dividends, \$0.63 per share                                     |                  |          |                                     | (8,912)           |            | (8,912)                                       |       |
| Shares repurchased or cancelled                                      | (886)            | (2,955)  | (19,414)                            |                   |            | (22,369)                                      |       |
| Balance December 31, 2007  | 13,600           | \$ 6,214 | \$ 9,821                            | \$ 116,906        | \$ 83      | \$ 133,024                                    |       |
| Net income   |                  |          |                                     | 21,676            |            | 21,676  |       |
| Change in other comprehensive income, net of tax                     |                  |          |                                     |                   | 2,207      | 2,207   |       |
| Stock compensation expense   |                  |          | 657                                 |                   |            | 657   |       |
| Shares issued for stock options exercised and employee benefit plans | 86               | 292      | 1,163                               |                   |            | 1,455   |       |
| Shares issued for non-vested restricted stock                        | 23               | 76       | 463                                 | (539)             |            |   |       |
| Cash dividends, \$0.68 per share                                     |                  |          |                                     | (9,135)           |            | (9,135)                                       |       |

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|                                 |        |          |          |            |          |            |
|---------------------------------|--------|----------|----------|------------|----------|------------|
| Shares repurchased or cancelled | (235)  | (780)    | (4,619)  | 15         | (5,384)  |            |
| Balance December 31, 2008       | 13,474 | \$ 5,802 | \$ 7,485 | \$ 128,923 | \$ 2,290 | \$ 144,500 |

See accompanying notes to consolidated financial statements.

**Table of Contents****Consolidated Statements of Comprehensive Income**

| (In thousands)   | Years Ended December 31 |                  |                  |
|--|-------------------------|------------------|------------------|
|  | 2008                    | 2007             | 2006             |
| <b>Net income</b>  | \$ 21,676               | \$ 24,052        | \$ 22,896        |
| Other comprehensive income (loss), net of tax:   |                         |                  |                  |
| Unrealized gains on securities available for sale:   |                         |                  |                  |
| Unrealized holding gains arising during the period (net of tax of \$967, \$601, and \$92 respectively)                 | 1,796                   | 1,114            | 165              |
| Reclassification adjustment for securities losses realized in income (net of tax of \$212, \$0, and \$0, respectively) | 395                     |                  |                  |
| Minimum pension liability adjustment (net of tax of \$9, \$(9), and \$10 respectively)                                 | 16                      | (18)             | 19               |
| Other comprehensive income   | 2,207                   | 1,096            | 184              |
| <b>Comprehensive income</b>  | <b>\$ 23,883</b>        | <b>\$ 25,148</b> | <b>\$ 23,080</b> |

See accompanying notes to consolidated financial statements.

**Table of Contents****Consolidated Statements of Cash Flows**

| (In thousands)  | Years Ended December 31 |                 |                 |
|---|-------------------------|-----------------|-----------------|
|   | 2008                    | 2007            | 2006            |
| <b>Operating activities</b>   |                         |                 |                 |
| Net income  | \$ 21,676               | \$ 24,052       | \$ 22,896       |
| Adjustments to reconcile net income to net cash provided by operating activities:                     |                         |                 |                 |
| Provision for loan losses   | 4,050                   | 3,525           | 2,100           |
| Depreciation, amortization and accretion, net   | 2,532                   | 2,496           | 2,981           |
| Amortization and write-off of debt issuance costs   |                         |                 | 897             |
| Provision for deferred income taxes (benefit)   | (1,526)                 | (1,548)         | (37)            |
| Loss on sale of securities available for sale   | 607                     |                 |                 |
| Gain on sale of mortgage loans held for sale  | (1,253)                 | (1,164)         | (1,270)         |
| Loss on the disposal of equipment   |                         | 15              | 56              |
| Loss (gain) on the sale of other real estate  | 9                       | 67              | (62)            |
| Valuation losses on other assets  | 1,330                   |                 |                 |
| Increase in value of bank owned life insurance  | (1,020)                 | (985)           | (914)           |
| Decrease (increase) in value of private investment fund   | 153                     | 287             | (216)           |
| Origination of mortgage loans held for sale   | (92,189)                | (90,474)        | (80,563)        |
| Proceeds from sales of mortgage loans held for sale   | 95,263                  | 90,902          | 85,242          |
| Stock compensation expense  | 657                     | 467             | 531             |
| Excess tax benefit from share-based compensation arrangements   | (188)                   | (53)            | (83)            |
| Increase in accrued interest receivable and other assets  | (4,520)                 | (2,837)         | (6,635)         |
| Increase (decrease) in accrued interest payable and other liabilities                                 | 1,826                   | (7,423)         | 9,728           |
| <b>Net cash provided by operating activities</b>  | <b>27,407</b>           | <b>17,327</b>   | <b>34,651</b>   |
| <b>Investing activities</b>   |                         |                 |                 |
| Purchases of securities available for sale  | (293,950)               | (98,202)        | (63,348)        |
| Proceeds from sales of securities available for sale  | 3,344                   |                 |                 |
| Proceeds from maturities of securities available for sale   | 282,025                 | 80,802          | 76,653          |
| Proceeds from maturities of securities held to maturity   | 1,086                   | 2,015           | 972             |
| Net increase in loans   | (151,229)               | (61,253)        | (95,945)        |
| Purchases of premises and equipment   | (3,260)                 | (4,887)         | (2,749)         |
| Proceeds from the sale of premises and equipment  |                         |                 | 138             |
| Proceeds from sales of other real estate  | 3,384                   | 6,090           | 2,603           |
| <b>Net cash used in investing activities</b>  | <b>(158,600)</b>        | <b>(75,435)</b> | <b>(81,676)</b> |
| <b>Financing activities</b>   |                         |                 |                 |
| Net increase in deposits  | 164,218                 | 3,465           | 71,885          |
| Net (decrease) increase in securities sold under agreements to repurchase and federal funds purchased | (42,182)                | 24,386          | 4,427           |
| Net (decrease) increase in other short-term borrowings  | (9,533)                 | 9,931           | (1,405)         |
| Proceeds from issuance of subordinated debentures   | 40,900                  |                 |                 |
| Issuance costs of subordinated debentures   | (1,414)                 |                 |                 |
| Repayments of subordinated debentures   | (30)                    | (30)            | (20,649)        |
| Repayments of Federal Home Loan Bank advances   | (20,000)                | (10,000)        | (10,000)        |
| Proceeds from Federal Home Loan Bank advances   |                         | 40,000          | 30,000          |
| Issuance of common stock for options and employee benefit plans                                       | 1,267                   | 1,193           | 1,539           |
| Excess tax benefits from share-based compensation arrangements  | 188                     | 53              | 83              |
| Common stock repurchases  | (5,384)                 | (22,369)        | (5,271)         |
| Cash dividends paid   | (9,053)                 | (8,870)         | (7,945)         |
| <b>Net cash provided by financing activities</b>  | <b>118,977</b>          | <b>37,759</b>   | <b>62,664</b>   |

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|   |           |           |           |
|---|-----------|-----------|-----------|
| <b>Net (decrease) increase in cash and cash equivalents</b> | (12,216)  | (20,349)  | 15,639    |
| <b>Cash and cash equivalents at beginning of year</b>       | 39,329    | 59,678    | 44,039    |
| <b>Cash and cash equivalents at end of year</b>             | \$ 27,113 | \$ 39,329 | \$ 59,678 |
| <b>Supplemental cash flow information:</b>                  |           |           |           |
| Income tax payments   | \$ 9,350  | \$ 10,275 | \$ 9,645  |
| Cash paid for interest                                      | 30,665    | 37,376    | 32,189    |
| <b>Supplemental non-cash activity:</b>                      |           |           |           |
| Transfers from loans to other real estate owned             | \$ 1,411  | \$ 5,991  | \$ 1,070  |

See accompanying notes to consolidated financial statements.



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**Notes to Consolidated Financial Statements**

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

**Principles of Consolidation and Nature of Operations**

The consolidated financial statements include the accounts of S.Y. Bancorp, Inc. (Bancorp) and its wholly owned subsidiaries, Stock Yards Bank & Trust Company (the Bank) and S.Y. Bancorp Capital Trust II. Significant intercompany transactions and accounts have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to the 2008 presentation.

The Bank is engaged in commercial banking services and trust and investment management services. The Bank's primary market area is Louisville, Kentucky and surrounding communities including southern Indiana. A secondary market is Indianapolis, Indiana where the Bank has two full service branches. During the second half of 2007 the Bank expanded to downtown Cincinnati, Ohio by opening a LPO and then converted the LPO to a full-service branch during the first quarter of 2008.

**Basis of Financial Statement Presentation and Use of Estimates**

The consolidated financial statements of Bancorp and its subsidiaries have been prepared in conformity with accounting principles generally accepted in the United States of America ( US GAAP ) and conform to predominant practices within the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of related revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and income tax assets, estimated liabilities and expense.

**Cash and Cash Equivalents**

Cash and cash equivalents include cash and due from banks and Federal funds sold as segregated in the accompanying consolidated balance sheets.

**Securities**

Securities that we have the intent and ability to hold until maturity are carried at amortized cost. Securities available for sale include securities that may be sold in response to changes in interest rates, resultant prepayment risk and other factors related to interest rate and prepayment risk changes. Securities available for sale are carried at fair value with unrealized gains or losses, net of tax effect, included in stockholders' equity. Amortization of premiums and accretion of discounts are recorded using the interest method over the life of the security. Gains or losses on sales of securities are computed on a specific identification cost basis for securities. For securities for which impairment is other than temporary, losses are reflected in operations and a new cost basis is established.

#### **Mortgage Loans Held for Sale**

Mortgage loans held for sale are carried at the lower of cost or market value on an individual loan basis. Gains on sales of mortgage loans are recorded at the time of disbursement by an investor at the difference between the sales proceeds and the loan's carrying value net of any origination costs. Prior to 2007, virtually all loans originated by the mortgage banking company were sold in the secondary market with servicing rights released. Beginning in 2007, the Bank began selling certain loans to FNMA with servicing rights retained.

#### **Loans**

Loans are stated at the unpaid principal balance less net deferred loan fees or costs. Loan fees, net of any costs, are deferred and amortized over the life of the related loan on an effective yield basis. Interest income on loans is recorded on the accrual basis except for those loans in a non-accrual income status. Loans are

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placed in a non-accrual income status when the prospects for recovering both principal and accrued interest are considered doubtful or when a default of principal or interest has existed for 90 days or more unless such a loan is well secured and in the process of collection. When a loan is placed on non-accrual status, any interest previously accrued but not yet collected is reversed against current income. Interest income is recorded on a cash basis during the period a loan is on non-accrual status so long as the recovery of principal is reasonably assured. Non-accrual loans may be returned to accrual status once principal recovery is reasonably assured.

Loans are classified as impaired when it is probable the Bank will be unable to collect interest and principal according to the terms of the loan agreement. These loans are measured based on the present value of future cash flows discounted at the loans' effective interest rate or at the estimated fair value of the loans' collateral, if applicable. Impaired loans do not accrue interest.

**Allowance for Loan Losses**

The allowance for loan losses is maintained at a level that adequately provides for probable losses inherent in the loan portfolio. Management determines the adequacy of the allowance based on reviews of individual credits and the underlying collateral, recent loss experience, current economic conditions, the risk characteristics of the various loan categories and such other factors that, in management's judgment, deserve current recognition in estimating loan losses. The allowance for loan losses is increased by the provision for loan losses and reduced by net loan charge-offs.

Various regulatory agencies, as an integral part of their examination process, periodically review the adequacy of Bancorp's allowance for loan losses. Such agencies may require Bancorp to make additional provisions to the allowance based upon their judgments about information available to them at the time of their examinations.

**Premises and Equipment**

Premises and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation of premises and equipment is computed using straight-line methods over the estimated useful lives of the assets ranging from 3 to 39 years. Leasehold improvements are amortized on the straight-line method over the terms of the related leases, including renewals, or over the useful lives of the improvements, whichever is shorter. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized.

**Other Assets**

Bank-owned life insurance is carried at net realizable value, which considers any applicable surrender charges. Also, the Bank maintains life insurance policies other than BOLI in conjunction with its non-qualified defined benefit and non-qualified compensation plans.

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Other real estate is carried at the lower of cost or estimated fair value minus estimated selling costs. Any write downs to fair value at the date of acquisition are charged to the allowance for loan losses. In certain situations, improvements to prepare assets for sale are capitalized if those costs increase the estimated fair value of the asset. Expenses incurred in maintaining assets, write downs to reflect subsequent declines in value, and realized gains or losses are reflected in operations and are included in non-interest income and expense. At December 31, 2008 and 2007, other real estate owned totaled \$1,560,000 and \$3,831,000, respectively.

The Company's investment in a domestic private investment fund is comprised of bank and other financial industry stocks and is accounted for in accordance with Statement of Position 78-9. In 2008, this investment was reclassified to other assets and the equity method of accounting is now applied. This investment was previously included in securities available for sale.

Mortgage servicing rights (MSRs) are amortized in proportion to and over the period of estimated net servicing income, considering appropriate prepayment assumptions. MSRs are evaluated quarterly for impairment by comparing the carrying value to the fair value. MSRs were written down to fair value at

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December 31, 2008, resulting in a valuation allowance of \$176,000. A corresponding charge was included in earnings for the year 2008.

The amount of goodwill is measured and evaluated annually for potential impairment. No impairment charges have been deemed necessary or recorded to date.

**Securities Sold Under Agreements to Repurchase**

Bancorp enters into sales of securities under agreement to repurchase at a specified future date. Such repurchase agreements are considered financing agreements and, accordingly, the obligation to repurchase assets sold is reflected as a liability in the consolidated balance sheets of Bancorp. Repurchase agreements are collateralized by debt securities which are owned and under the control of Bancorp. These agreements are used in conjunction with corporate sweep accounts. Because the Bank may not pay interest to corporate depositors, this sweep arrangement allows excess deposit balances to be automatically transferred into a repurchase agreement account where the funds earn interest.

**Repurchased Shares of Common Stock**

The repurchase of Bancorp's common stock is recorded at cost, and repurchased shares return to the status of authorized, but unissued. Amounts recorded in common stock are based on the stated value of the shares, as there is no par value. Residual amounts are recorded in additional paid in capital.

**Income Taxes**

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, 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 December 31, 2008, the amount accrued for the potential payment of interest and penalties was \$20,000.

Bancorp accounts for income taxes using the asset and liability method. The objective of the asset and liability method is to establish deferred tax assets and liabilities for temporary differences between the financial reporting and the tax bases of Bancorp's assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of income in the period that includes the enactment date. Bancorp invests in certain low-income housing projects that yield investment tax credits and tax deductible losses. These tax benefits are recognized in income tax expense using an effective yield method over the life of the investment.

#### **Net Income Per Share**

Basic net income per common share is determined by dividing net income by the weighted average number of shares of common stock outstanding. Diluted net income per share is determined by dividing net income by the weighted average number of shares of common stock outstanding plus the weighted average number of

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shares that would be issued upon exercise of dilutive options, assuming proceeds are used to repurchase shares under the treasury stock method.

**Comprehensive Income**

Comprehensive income is defined as the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. For Bancorp, this includes net income, changes in unrealized gains and losses on available for sale investment securities, net of taxes, and minimum pension liability adjustments, net of taxes.

**Segment Information**

The Bank provides a broad range of financial services to individuals, corporations and others through its twenty-eight full service banking locations as of December 31, 2008. These services include lending, receiving deposits, providing cash management services, safe deposit box rental, brokerage activities, mortgage lending and investment management and trust activities. The Bank's chief decision makers monitor the results of the various banking products and services and accordingly, the Bank's operations are considered by management to be aggregated in two reportable operating segments: commercial banking and investment management and trust.

**Stock-Based Compensation**

On January 1, 2006, Bancorp adopted the modified version of prospective application of Statement of Financial Standard No. 123 (R) Share-based Payment, ( SFAS No. 123R ). Under this method, the fair value of all new and modified awards granted subsequent to the date of adoption 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.

**(2) Restrictions on Cash and Due from Banks**

The Bank is required to maintain an average reserve balance in cash or with the Federal Reserve Bank relating to customer deposits. The amount of those required reserve balances was approximately \$919,000 and \$838,000 at December 31, 2008 and 2007, respectively.

**Table of Contents****(3) Securities**

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

| (In thousands)                                       | Amortized<br>Cost | Gains    | Unrealized<br>Losses | Fair Value |
|--|-------------------|----------|----------------------|------------|
| <b>December 31, 2008</b>                             |                   |          |                      |            |
| U.S. Treasury and other U.S. government obligations  | \$ 6,796          | \$ 159   | \$                   | \$ 6,955   |
| Government sponsored enterprise obligations          | 104,137           | 3,480    |                      | 107,617    |
| Mortgage-backed securities                           | 28,898            | 379      | 14                   | 29,263     |
| Obligations of states and political subdivisions     | 26,441            | 712      | 69                   | 27,084     |
| Trust preferred securities of financial institutions | 3,233             |          | 781                  | 2,452      |
|  | \$ 169,505        | \$ 4,730 | \$ 864               | \$ 173,371 |
| <b>December 31, 2007</b>                             |                   |          |                      |            |
| U.S. Treasury and other U.S. government obligations  | \$ 9,720          | \$ 101   | \$ 16                | \$ 9,805   |
| Government sponsored enterprise obligations          | 109,809           | 399      | 194                  | 110,014    |
| Mortgage-backed securities                           | 11,420            | 44       | 151                  | 11,313     |
| Obligations of states and political subdivisions     | 23,794            | 550      | 95                   | 24,249     |
| Trust preferred securities of financial institutions | 3,233             |          | 16                   | 3,217      |
| Other  | 3,951             |          |                      | 3,951      |
|  | \$ 161,927        | \$ 1,094 | \$ 472               | \$ 162,549 |

For 2007, other securities consisted of preferred securities of other bank holding companies. These securities, with a cost of \$3,951,000, were sold in August 2008, resulting in a loss of \$607,000. There were no sales of securities in 2006 or 2007.



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

| (In thousands)                                   | Amortized<br>Cost | Gains | Unrealized<br>Losses | Fair Value |
|--|-------------------|-------|----------------------|------------|
| <b>December 31, 2008</b>                         |                   |       |                      |            |
| Mortgage-backed securities                       | \$ 43             | \$ 1  | \$                   | \$ 44      |
| Obligations of states and political subdivisions |                   |       |                      |            |
|  | \$ 43             | \$ 1  | \$                   | \$ 44      |
| <b>December 31, 2007</b>                         |                   |       |                      |            |
| Mortgage-backed securities                       | \$ 59             | \$ 2  | \$                   | \$ 61      |
| Obligations of states and political subdivisions | 1,070             |       | 3                    | 1,067      |
|  | \$ 1,129          | \$ 2  | \$ 3                 | \$ 1,128   |

A summary of securities as of December 31, 2008 based on maturity is presented below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

| (In thousands)                        | Securities<br>Available for Sale |                           | Securities<br>Held to Maturity |            |
|---------------------------------------|----------------------------------|---------------------------|--------------------------------|------------|
|                                       | Amortized<br>Cost                | Approximate<br>Fair Value | Amortized Cost                 | Fair Value |
| Due within one year                   | \$ 64,205                        | \$ 64,577                 | \$                             | \$         |
| Due after one year through five years | 38,806                           | 40,277                    |                                |            |
| Due after five year through ten years | 35,137                           | 37,563                    | 32                             | 32         |
| Due after ten years                   | 31,357                           | 30,954                    | 11                             | 12         |
|                                       | \$ 169,505                       | \$ 173,371                | \$ 43                          | \$ 44      |

Securities with a carrying value of approximately \$96,179,000 at December 31, 2008 and \$108,610,000 at December 31, 2007 were pledged to secure the accounts of commercial depositors in cash management accounts, public deposits and certain borrowings.

At year end 2008 and 2007, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity.

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Securities with unrealized losses at December 31, 2008 and 2007, not recognized in income are as follows:

| (In thousands)                                       | Less than 12 months |                   | 12 months or more |                   | Total      |                   |
|--|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|  | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| <b>December 31, 2008</b>                             |                     |                   |                   |                   |            |                   |
| U.S. Treasury and other U.S. government obligations  | \$                  | \$                | \$                | \$                | \$         | \$                |
| Government sponsored enterprise obligations          |                     |                   |                   |                   |            |                   |
| Mortgage-backed securities                           | 6,035               | 14                |                   |                   | 6,035      | 14                |
| Obligations of states and political subdivisions     | 4,259               | 69                |                   |                   | 4,259      | 69                |
| Trust preferred securities of financial institutions | 2,452               | 781               |                   |                   | 2,452      | 781               |
| Total temporarily impaired securities                | \$ 12,746           | \$ 864            | \$                | \$                | \$ 12,746  | \$ 864            |
| <b>December 31, 2007</b>                             |                     |                   |                   |                   |            |                   |
| U.S. Treasury and other U.S. government obligations  | \$                  | \$                | \$ 3,784          | \$ 16             | \$ 3,784   | \$ 16             |
| Government sponsored enterprise obligations          |                     |                   | 28,765            | 194               | 28,765     | 194               |
| Mortgage-backed securities                           |                     |                   | 10,188            | 151               | 10,188     | 151               |
| Obligations of states and political subdivisions     |                     |                   | 7,979             | 95                | 7,979      | 95                |
| Trust preferred securities of financial institutions | 1,233               | 16                |                   |                   | 1,233      | 16                |
| Total temporarily impaired securities                | \$ 1,233            | \$ 16             | \$ 50,716         | \$ 456            | \$ 51,949  | \$ 472            |

Unrealized losses on Bancorp's bond portfolio have not been recognized in income because the bonds 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 an increase in prevailing interest rates since the purchase date. The fair value is expected to recover as the securities reach their maturity date and/or interest rates decline. These investments consist of 19 and 51 separate investment positions as of December 31, 2008 and 2007 that are not considered other-than-temporarily impaired. Based on these detailed reviews, the Company has not recorded other-than-temporary losses on any securities held at December 31, 2008. However, other-than-temporary impairment may arise in future periods due to further deterioration in the general economy and national housing markets, changing cash flows, loss severities and delinquency levels of the securities underlying collateral, which would negatively affect the Company's financial results.

Table of Contents**(4) Loans**

The composition of loans follows:

| (In thousands)               | December 31, |              |
|------------------------------|--------------|--------------|
|                              | 2008         | 2007         |
| Commercial and industrial    | \$ 348,174   | \$ 309,506   |
| Construction and development | 167,402      | 144,668      |
| Real estate mortgage:        |              |              |
| Commercial investment        | 248,308      | 240,610      |
| Owner occupied commercial    | 249,164      | 200,122      |
| 1-4 family residential       | 160,322      | 145,362      |
| Home equity                  | 145,508      | 136,962      |
| Consumer                     | 30,759       | 24,708       |
|                              | \$ 1,349,637 | \$ 1,201,938 |

Loan balances include net deferred loan fees of \$114,000 at December 31, 2008 and \$162,000 at December 31, 2007. The Bank's credit exposure is diversified with secured and unsecured loans to individuals, small businesses and corporations. No specific industry concentration exceeds ten percent of loans. While the Bank has a diversified loan portfolio, a customer's ability to honor contracts is somewhat dependent upon the economic stability and geographic region and/or industry in which that customer does business. Loans outstanding and related unfunded commitments are primarily concentrated within the Bank's current market areas, which encompass Louisville, Kentucky and surrounding communities including southern Indiana along with Indianapolis, Indiana and Cincinnati, Ohio.

**Information about impaired loans follows:**

| (In thousands)                                    | December 31, |          |
|---|--------------|----------|
|   | 2008         | 2007     |
| Principal balance of impaired loans               | \$ 4,455     | \$ 2,964 |
| Impaired loans with a valuation allowance         | 2,724        | 1,857    |
| Amount of valuation allowance                     | 1,255        | 717      |
| Impaired loans with no valuation allowance        | 1,731        | 1,107    |
| Average balance of impaired loans during the year | 4,054        | 4,120    |

Interest income on impaired or non-accrual loans (cash basis) was \$174,000, \$55,000 and \$164,000 in 2008, 2007, and 2006, respectively. Interest income that would have been recorded if non-accrual loans were on a current basis in accordance with their original terms was \$393,000, \$241,000 and \$554,000 in 2008, 2007 and 2006, respectively.

Non-performing loans include the balance of impaired loans plus any loans over ninety days past due and still accruing interest. Loans past due more than ninety days or more and still accruing interest amounted to \$255,000 in 2008 and \$406,000 in 2007.



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Loans to directors and their associates, including loans to companies for which directors are principal owners, and executive officers are presented in the following table. Included in new loans and repayments are advances and repayments on lines of credit.

| Loans to directors and executive officers<br>(in thousands)                   | Year Ended December 31, |          |
|---|-------------------------|----------|
|   | 2008                    | 2007     |
| <b>Balance as of January 1</b>  | \$ 5,810                | \$ 8,007 |
| New loans and advances on lines of credit                                     | 18,756                  | 47,300   |
| Repayments on loans and lines of credit                                       | 19,622                  | 49,497   |
| <b>Balance as of December 31</b>  | \$ 4,944                | \$ 5,810 |
| <b>Deposit balances of directors and executive officers as of December 31</b> | \$ 1,596                | \$ 1,810 |

An analysis of the changes in the allowance for loan losses for the years ended December 31, 2008, 2007, and 2006 follows:

| (In thousands)                | Year Ended December 31, |           |           |
|-------------------------------|-------------------------|-----------|-----------|
|                               | 2008                    | 2007      | 2006      |
| <b>Balance at January 1</b>   | \$ 13,450               | \$ 12,203 | \$ 12,035 |
| Provision for loan losses     | 4,050                   | 3,525     | 2,100     |
| Loans charged off             | (2,963)                 | (3,111)   | (2,774)   |
| Recoveries                    | 844                     | 833       | 842       |
| Net loan charge-offs          | (2,119)                 | (2,278)   | (1,932)   |
| <b>Balance at December 31</b> | \$ 15,381               | \$ 13,450 | \$ 12,203 |

**(5) Premises and Equipment**

A summary of premises and equipment follows:

| (In thousands)                            | December 31, |           |
|---|--------------|-----------|
|   | 2008         | 2007      |
| Land                                      | \$ 4,628     | \$ 4,586  |
| Buildings and improvements                | 26,395       | 24,519    |
| Furniture and equipment                   | 18,024       | 16,428    |
| Construction in progress                  | 633          | 886       |
|   | 49,680       | 46,419    |
| Accumulated depreciation and amortization | (21,754)     | (19,224)  |
|   | \$ 27,926    | \$ 27,195 |

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Depreciation expense related to premises and equipment was \$2,501,000 in 2008, \$2,500,000 in 2007 and \$2,914,000 in 2006.

Table of Contents**(6) Other Assets**

A summary of the major components of other assets follows:

| (In thousands)   | December 31, |           |
|--|--------------|-----------|
|  | 2008         | 2007      |
| Cash surrender value of life insurance other than BOLI | \$ 6,721     | \$ 7,120  |
| Other real estate owned and other foreclosed property  | 1,560        | 3,831     |
| Net deferred tax asset                                 | 5,717        | 5,379     |
| Goodwill   | 682          | 682       |
| Tax credit investments                                 | 2,977        | 1,831     |
| Domestic private equity fund                           | 1,776        | 1,929     |
| Investment in bank in expansion market                 | 520          | 1,386     |
| Common securities of S.Y. Bancorp Capital Trust II     | 900          |           |
| Unamortized trust preferred securities issuance costs  | 1,414        |           |
| Mortgage servicing rights                              | 426          | 138       |
| Other short term receivables                           | 2,927        | 1,291     |
| Other  | 3,063        | 1,602     |
|  | \$ 28,683    | \$ 25,189 |

**(7) Income Taxes**

Income taxes consist of the following:

| (In thousands)   | Year Ended December 31, |           |           |
|--|-------------------------|-----------|-----------|
|  | 2008                    | 2007      | 2006      |
| <b>Expense (benefit) applicable to operations:</b>                   |                         |           |           |
| Current  | \$ 11,582               | \$ 11,463 | \$ 10,999 |
| Deferred   | (1,526)                 | (1,548)   | (37)      |
| Total applicable to operations                                       | 10,056                  | 9,915     | 10,962    |
| <b>Charged (credited) to stockholders equity:</b>                    |                         |           |           |
| Unrealized gain on securities available for sale                     | 967                     | 601       | 92        |
| Reclassification adjustment for securities losses realized in income | 212                     |           |           |
| Stock options exercised  | (188)                   | (53)      | (83)      |
| Minimum pension liability adjustment                                 | 9                       | (9)       | 10        |
|  | \$ 11,056               | \$ 10,454 | \$ 10,981 |





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An analysis of the difference between the statutory and effective tax rates follows:

|  | 2008   | Year Ended December 31,<br>2007 | 2006   |
|--|--------|---------------------------------|--------|
| U.S. federal income tax rate           | 35.0%  | 35.0%                           | 35.0%  |
| Tax exempt interest income             | (2.3)% | (2.3)%                          | (2.5)% |
| Tax credits                            | (1.0)% | (2.9)%                          | (0.8)% |
| Cash surrender value of life insurance | (1.3)% | (1.6)%                          | (1.2)% |
| Other, net                             | 1.3%   | 1.0%                            | 1.9%   |
|  | 31.7%  | 29.2%                           | 32.4%  |

The effects of temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities were as follows:

| (In thousands)                        | 2008            | December 31,<br>2007 |
|---------------------------------------|-----------------|----------------------|
| <b>Deferred tax assets</b>            |                 |                      |
| Allowance for loan losses             | \$ 5,542        | \$ 4,827             |
| Deferred compensation                 | 2,186           | 2,118                |
| Other                                 | 830             | 189                  |
| <b>Total deferred tax assets</b>      | <b>8,558</b>    | <b>7,134</b>         |
| <b>Deferred tax liabilities</b>       |                 |                      |
| Securities                            | 2,338           | 1,041                |
| Property and equipment                | 359             | 481                  |
| Other                                 | 144             | 233                  |
| <b>Total deferred tax liabilities</b> | <b>2,841</b>    | <b>1,755</b>         |
| <b>Net deferred tax asset</b>         | <b>\$ 5,717</b> | <b>\$ 5,379</b>      |

No valuation allowance for deferred tax assets was recorded as of December 31, 2008 and 2007 because Bancorp has sufficient prior taxable income to allow for utilization of the deductible temporary differences within the carryback period. Management believes that it is more likely than not that all of the deferred tax assets will be realized.

Effective January 1, 2007, Bancorp adopted Financial Accounting Standards Board Interpretation No. 48 Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). 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, 2008 and 2007, the gross amount of unrecognized tax benefits was \$230,000.

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

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uncertainty, status of examination, litigation and legislative activity and the addition or elimination of uncertain tax positions.

Bancorp's policy is to report interest and penalties, if any, related to unrecognized tax benefits in income tax expense. As of the date of adoption of FIN 48, the amount accrued for the potential payment of interest and

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penalties was \$31,000 and at December 31, 2008 and 2007 that amount was \$20,000. Federal and state income tax returns are subject to examination from the 2003 tax return year and forward.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| (In thousands)            | 2008   | 2007   |
|---------------------------|--------|--------|
| Balance as of January 1   | \$ 230 | \$ 311 |
| Lapse of statute          |        | (81)   |
| Balance as of December 31 | \$ 230 | \$ 230 |

In 2007, recognition of the tax benefits increased net income, resulting in a decrease in the effective tax rate.

**(8) Deposits**

The composition of interest bearing deposits follows:

| (In thousands)                   | 2008         | December 31, | 2007    |
|----------------------------------|--------------|--------------|---------|
| Interest bearing demand          | \$ 220,245   | \$           | 208,327 |
| Savings                          | 45,934       |              | 38,758  |
| Money market                     | 326,866      |              | 265,760 |
| Time deposits greater than \$100 | 191,876      |              | 145,877 |
| Other time deposits              | 303,226      |              | 277,508 |
|                                  | \$ 1,088,147 | \$           | 936,230 |

Interest expense related to certificates of deposit and other time deposits in denominations of \$100,000 or more was \$7,053,000, \$6,904,000, and \$6,276,000, respectively, for the years ended December 31, 2008, 2007 and 2006.

At December 31, 2008, the scheduled maturities of time deposits were as follows:

| (In thousands) | 2009       | 2010   |
|----------------|------------|--------|
|                | \$ 370,937 | 88,512 |

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|            |            |
|------------|------------|
| 2011       | 12,851     |
| 2012       | 12,969     |
| 2013       | 7,901      |
| Thereafter | 1,932      |
|            | \$ 495,102 |

Table of Contents**(9) Securities Sold Under Agreements to Repurchase and Other Short-Term Borrowings**

Securities sold under agreements to repurchase are a funding source of the Bank and are primarily used by commercial customers for cash management services. Securities sold under agreements to repurchase generally mature within one to four days from the transaction date. Information concerning securities sold under agreements to repurchase is summarized as follows:

| (Dollars in thousands)                    | 2008      | December 31,<br>2007 |
|---|-----------|----------------------|
| Average balance during the year           | \$ 65,824 | \$ 83,775            |
| Average interest rate during the year     | 1.28%     | 3.27%                |
| Maximum month-end balance during the year | \$ 73,988 | \$ 95,295            |

Also, Bancorp has a \$20,000,000 line of credit with a local correspondent bank. As of December 31, 2008, the outstanding balance of this line was \$0. The line matures in July 2009 and interest is charged quarterly at a rate of prime minus 40 basis points.

**(10) Advances from the Federal Home Loan Bank**

The Bank has an agreement with the Federal Home Loan Bank of Cincinnati (FHLB) that enables the Bank to borrow up to \$111 million under terms to be established at the time of the advance. 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 had outstanding borrowings of \$70,000,000, at December 31, 2008, via three separate advances. The first advance is a fixed rate, non-callable advance of \$30,000,000. The second advance of \$20,000,000 is a fixed rate advance eligible to be called by the FHLB quarterly, with the next call date in March 2009, and then quarterly going forward until its maximum maturity in December 2010. The third advance of \$20,000,000 is a fixed rate advance eligible to be called by the FHLB quarterly, with the next call date in February of 2009, and then quarterly going forward until its maximum maturity in May 2012. At December 31, 2007, the Bank had four fixed rate advances totaling \$90 million. Two advances were callable and two were non-callable. The Bank views the borrowings as a low cost alternative to higher cost certificates of deposit to fund loan growth.

The following is a summary of the contractual maturities and average rates:

| (In thousands) | December 31, 2008 |       | December 31, 2007 |       |
|----------------|-------------------|-------|-------------------|-------|
|                | Advance           | Rate  | Advance           | Rate  |
| 2008           | \$ 20,000         |       | \$ 20,000         | 4.83% |
| 2009           | 30,000            | 5.02% | 30,000            | 5.02% |
| 2010           | 20,000            | 3.69% | 20,000            | 3.69% |
| 2011           |                   |       |                   |       |
| 2012           | 20,000            | 4.58% | 20,000            | 4.58% |
|                | \$ 70,000         | 4.51% | \$ 90,000         | 4.58% |

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The Bank also has a standby letter of credit from the FHLB with \$10 million outstanding at December 31, 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 \$250,000 per account protection provided by the FDIC to be backed by some form of collateral. The standby letter of credit from the FHLB collateralizes these accounts.

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**(11) Subordinated Debentures**

In December 2008, the Company formed S.Y. Bancorp Capital Trust II, a Delaware statutory trust and 100%-owned finance subsidiary. On December 23, 2008, S.Y. Bancorp Capital Trust II issued \$30.0 million of 10% fixed rate cumulative trust preferred securities and invested the proceeds, along with \$900,000 received from the purchase of its common equity securities, in \$30.9 million of a fixed rate subordinated debenture of the Company. The principal asset of S.Y. Bancorp Capital Trust II is a \$30.9 million subordinated debenture of Bancorp. The interest rate on both the trust preferred securities and the subordinated debenture is fixed at 10.00%. The Company may redeem all or part of the trust preferred securities at any time on or after December 31, 2013 at a redemption price equal to 100% of the aggregate liquidation amount of the trust preferred securities plus any accumulated and unpaid distributions thereon to the date of redemption. The trust preferred securities are subject to mandatory redemption when the subordinated debenture is paid at maturity in 2038 or upon any earlier redemption of the debenture. The trust preferred securities may also be redeemed at any time in the event of unfavorable changes in certain laws or regulations. The obligations of Bancorp with respect to the issuance of the Securities constituted a full and unconditional guarantee by Bancorp of the Trust's obligation with respect to the Securities. Unamortized issuance costs of \$1,556,000 will be recognized as non-interest expense over the life of the securities.

On September 30, 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 December 31, 2008 the Bank had chosen the prime rate related alternative and will reevaluate periodically to ensure the most favorable pricing. The debentures mature in 2018, with a call option to the Bank on or after December 31, 2010. The only financial covenant of the debt agreement requires that the Bank remain well capitalized as defined by its primary regulator. The primary source of funds for payments of the debentures is dividends received from the Bank, which is limited by regulatory dividend restrictions. See Note 16 for details on dividend restrictions.

In addition, the Bank had subordinated debentures outstanding amounting to \$60,000 at December 31, 2008 and \$90,000 at December 31, 2007. The interest is at a variable rate and was 6.25% at December 31, 2008 and 7.25% at December 31, 2007. The remaining \$60,000 matures in 2049, of which the owner may redeem the debentures at any time.

In 2001, S.Y. Bancorp Capital Trust I, a Delaware statutory business trust and 100%-owned finance subsidiary of Bancorp, issued \$20.0 million of 9.0% Cumulative Trust Preferred Securities ( Securities ). The securities and subordinated debenture bore interest at the rate of 9.0% and on July 1, 2006, Bancorp redeemed these securities at par value. Remaining unamortized issuance costs of \$879,000 were recognized as non-interest expense in the third quarter of 2006.

**(12) Preferred Stock**

**At Bancorp's 2003 Annual Meeting of Shareholders, the shareholders approved an amendment to the Articles of Incorporation to create a class of preferred stock and authorize 1,000,000 shares of this preferred stock with no par value. The relative rights, preferences and other terms of this stock or any series within the class will be determined by the board of directors prior to any issuance. Some of this preferred stock will be used in connection with a shareholders' rights plan upon the occurrence of certain triggering events. None of this stock had been issued as of December 31, 2008.**





Table of Contents**(13) Net Income per Share and Common Stock Dividends**

The following table reflects the numerators (net income) and denominators (average shares outstanding) for the basic and diluted net income per share computations:

| (In thousands, except per share data)                    | 2008      | 2007      | 2006      |
|--|-----------|-----------|-----------|
| Net income, basic and diluted                            | \$ 21,676 | \$ 24,052 | \$ 22,896 |
| Average shares outstanding for basic EPS calculation     | 13,440    | 14,168    | 14,462    |
| Effect of dilutive securities                            | 190       | 221       | 279       |
| Average shares outstanding including dilutive securities | 13,630    | 14,389    | 14,741    |
| Net income per share, basic                              | \$ 1.61   | \$ 1.70   | \$ 1.58   |
| Net income per share, diluted                            | \$ 1.59   | \$ 1.67   | \$ 1.55   |

**(14) Employee Benefit Plans**

The Bank has a combined employee stock ownership and profit sharing plan ( KSOP ). The plan is a defined contribution plan and is available to all employees meeting certain eligibility requirements. Expenses of the plan for 2008, 2007, and 2006 were \$992,000, \$1,224,000, and \$929,000, respectively. Employee and employer contributions are made in accordance with the terms of the plan. As of December 31, 2008 and 2007, the KSOP held 365,012 and 369,392, respectively, shares of Bancorp stock.

In addition the Bank has non-qualified excess plans into which directors and certain senior officers may defer director fees or salary. The Bank contributed approximately \$61,000, \$60,000, and \$190,000 to the senior officers plan in 2008, 2007 and 2006 respectively. At December 31, 2008 and 2007, the amounts included in other liabilities in the consolidated financial statements for this plan were \$1,431,000 and \$2,072,000. The Bank also sponsors an unfunded, non-qualified, defined benefit retirement plan for certain key officers. Benefits vest based on years of service. Bancorp uses a December 31 measurement date for this plan. At December 31, 2008 and 2007, the accumulated benefit obligation for the plan included in other liabilities in the consolidated financial statements was \$1,928,000 and \$1,993,000, respectively. A discount rate of 5.75% was used in 2008 and 2007 in determining the actuarial present value of the projected benefit obligation. The Bank funds retirement benefits for both non-qualified plans as they are disbursed and maintains life insurance policies on certain current and former executives, the proceeds from which will offset the cost of benefits. Under FASB No. 158, Accounting for Defined Benefit Pension and Other Postretirement Plans the liability for the Bank's plan met the benefit obligation as of December 31, 2008 and 2007.

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Information about the components of the net periodic benefit cost of the defined benefit plan follows:

| (Dollars in thousands)                          | 2008   | Year ended December 31,<br>2007 | 2006   |
|---|--------|---------------------------------|--------|
| <b>Components of net periodic benefit cost:</b> |        |                                 |        |
| Service cost                                    | \$     | \$                              | \$     |
| Interest cost                                   | 106    | 110                             | 113    |
| Expected return on plan assets                  |        |                                 |        |
| Amortization of prior service cost              |        |                                 |        |
| Amortization of net losses                      | 23     | 24                              | 26     |
| Net periodic benefit cost                       | \$ 129 | \$ 134                          | \$ 139 |

The following table sets forth the plan's benefit obligations and funded status at December 31, 2008 and 2007:

| (Dollars in thousands)                                     | 2008     | 2007     |
|--|----------|----------|
| <b>Pension benefits</b>                                    |          |          |
| Benefit obligation at December 31                          | \$ 1,928 | \$ 1,993 |
| Fair value of plan assets at December 31                   |          |          |
| Funded status  | (1,928)  | (1,993)  |
| Liability accrued in the consolidated financial statements | \$ 1,928 | \$ 1,993 |

The following table sets forth additional information concerning the plan as of December 31, 2008 and 2007:

| (Dollars in thousands)  | 2008   | 2007   |
|-------------------------|--------|--------|
| <b>Pension benefits</b> |        |        |
| Benefit cost            | \$ 129 | \$ 134 |
| Employer contribution   |        |        |
| Employee contribution   |        |        |
| Benefits paid           | 174    | 174    |

The benefits expected to be paid in each year from 2009 to 2013 are \$174,000, \$153,000, \$123,000, \$123,000 and \$123,000, respectively. The aggregate benefits expected to be paid beyond 2013 are \$3,866,000. The expected benefits to be paid are based on the same assumptions used to measure the Bank's benefit obligation at December 31, 2008.

There are no obligations for other post-retirement and post-employment benefits.

**(15) Stock-Based Compensation**

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 December 21, 2008, there were 284,513 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.

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In accordance with SFAS No. 123R, Bancorp recognized, within salaries and employee benefits in the consolidated income statement, stock-based compensation expense of \$657,000, \$467,000 and \$531,000 and a related deferred tax benefit of \$230,000, \$163,000 and \$186,000 resulting in a reduction of net income of \$427,000, \$304,000 and \$345,000 or \$0.03, \$0.02 and \$0.02 per basic and diluted shares for the years ended December 31, 2008, 2007 and 2006, respectively. As of December 31, 2008 Bancorp has \$692,000 of unrecognized stock-based compensation expense that will be recorded as compensation expense over the next 4 years, the weighted average remaining life of the stock options and \$397,000 of unrecognized stock-based compensation expense that will be recorded over the next 5 years, the weighted average remaining life of the restricted shares. Bancorp received cash of \$1,218,000, \$1,193,000 and \$1,539,000 from the exercise of options during 2008, 2007 and 2006, 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 has 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.

The fair value of Bancorp's stock options is estimated at the date of grant using the Black-Scholes option pricing model, a leading formula for calculating the value of stock options and SARs. 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 option valuations:

|   | 2008   | 2007   | 2006   |
|---|--------|--------|--------|
| <b>Assumptions Used in Option Valuation</b> |        |        |        |
| Dividend yield                              | 1.95%  | 1.81%  | 1.63%  |
| Expected volatility                         | 14.99% | 14.49% | 16.53% |
| Risk free interest rate                     | 3.84%  | 4.69%  | 4.42%  |
| Forfeitures                                 | 5.65%  | 5.55%  | 5.69%  |
| Expected life of options (in years)         | 7.46   | 7.70   | 7.70   |

The expected life of options and SARs is based on actual experience of past like-term options. All outstanding options have a 10-year contractual term. Bancorp evaluated historical exercise and post-vesting termination behavior when determining the expected life for options granted during 2008, 2007 and 2006.

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

Activity with respect to outstanding options and SARs follows:

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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> |
|------------------------|-----------------------------|-----------------------|--|--|--|--|
| At December 31, 2007   |                             |                       |  |  |  |  |
| 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   |  |
| Total outstanding      | 1,016                       | 9.76-26.83            | 19.65  | 4,807                                    | 4.34   |  |
| Granted                | 114                         | 23.37                 | 23.37  | 471                                      | 4.57   |  |
| Exercised              | (86)                        | 9.76-26.83            | 14.76  | 932                                      |  |  |