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

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

Title of each class:	Name of each exchange on which registered:
Common Stock, no par value	NASDAQ
Preferred Share Purchase Rights	NASDAQ
10.00% Cumulative Trust Preferred Securities and the guarantee with respect thereto	NASDAQ

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 o No x**

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 o No x**

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

Indicate by check mark 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. **o**

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

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

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

The 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 chose 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.

Name and Age of Executive Officer	Position and Offices with Bancorp
David P. Heintzman Age 49	Chairman, Chief Executive Officer, and Director
James A. Hillebrand Age 40	President and Director
Kathy C. Thompson Age 47	Senior Executive Vice President and Director
Nancy B. Davis 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

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.

	2008			2007		
Quarter	**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.

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

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.

	Period Ending					
Index	**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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Item 6. Selected Financial Data

Selected Consolidated Financial Data

(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
Per share data					
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
Average balances					
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
Selected ratios					
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.

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

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.

Comparative information regarding net interest income follows:

(Dollars in thousands)	2008	2007	2006	2008/2007 Change	2007/2006 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.

	Net Interest Income % Change
Increase 200 bp	12.39

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

	2008/2007			2007/2006		
		Increase (Decrease) Due to			Increase (Decrease) Due to	
(In thousands)	**Net Change**	**Rate**	**Volume**	**Net Change**	**Rate**	**Volume**
Interest income						
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)
Securities						
Taxable	410	(271)	681	408	350	58
Tax-exempt	(97)	42	(139)	(210)	40	(250)
Total interest income	(4,172)	(14,316)	10,144	4,965	528	4,437
Interest expense						
Deposits						
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
Securities sold under agreements to repurchase and federal funds purchased	(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)
Total interest expense	(7,276)	(12,779)	5,503	5,098	3,187	1,911
Net interest income	$ 3,104	$ (1,537)	$ 4,641	$ (133)	$ (2,659)	$ 2,526

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.

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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 Change	%	2007/2006 Change	%
Non-interest income							
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)%

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 Change	%	2007/2006 Change	%
Non-interest expense							
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.

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 Change	%	2007/2006 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%

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

	Year 2008			Year 2007			Year 2006		
(Dollars in thousands)	Average Balances	Interest	Average Rate	Average Balances	Interest	Average Rate	Average Balances	Interest	Average Rate
Earning assets									
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%
Securities									
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%
Total earning assets	1,472,098	88,135	5.99%	1,315,925	92,307	7.01%	1,256,591	87,342	6.95%
Less allowance for loan losses	14,600			12,560			12,406		
	1,457,498			1,303,365			1,244,185		
Non-earning assets									
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		
Total assets	$ 1,567,967			$ 1,413,614			$ 1,353,651		

	Year 2008			Year 2007			Year 2006		
(Dollars in thousands)	Average Balances	Interest	Average Rate	Average Balances	Interest	Average Rate	Average Balances	Interest	Average Rate
Interest bearing liabilities									
Deposits									