

S Y BANCORP INC  
Form 10-K  
March 13, 2008

**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, 2007**

**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:  
Common Stock, no par value  
Preferred Share Purchase Rights**

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

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

**None**

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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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes  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, 2007 (the last business day of the registrant's most recently completed second fiscal quarter) was \$300,613,000.

The number of shares of the registrant's Common Stock, no par value, outstanding as of March 5, 2008, was 13,411,765.

**Documents Incorporated By Reference**

**Portions of Registrant's definitive proxy statement related to Registrant's Annual Meeting of Shareholders to be held on April 23, 2008 (the Proxy Statement), are incorporated by reference into Part III of this Form 10-K.**



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

**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 I (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 business trust that has no current business operations.

**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 21 to Bancorp's consolidated financial statements for the year ended December 31, 2007 for information relating to the Bank's business segments.

At December 31, 2007, the Bank had 446 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.

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 \$100,000 per depositor for time and demand deposit accounts, and \$250,000 per depositor for self-directed retirement accounts.

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.

The USA Patriot Act of 2001 was enacted in response to the 2001 terrorist attacks in the U.S. and is intended to strengthen U.S. law enforcement s and the intelligence community s ability to work cohesively to combat terrorism. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and requires various regulations, including: (a) due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts for non-U.S. persons; (b) standards for verifying customer identification at account opening; (c) rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering; (d) currency transaction reports (CTRs) for transactions exceeding \$10,000; and (e) filing of suspicious activities reports (SARs) if the Bank believes a customer may be in violation of U.S. laws and regulations.

#### **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.

**Item 1A. Risk Factors**

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

**Fluctuations in interest rates could reduce Bancorp's profitability.**

Bancorp's primary source of income is from the difference between interest earned on loans and investments and the interest paid on deposits and borrowings. Management expects to periodically experience gaps in the interest rate sensitivities of Bancorp's assets and liabilities, meaning that either Bancorp's interest-bearing liabilities will be more sensitive to changes in market interest rates than Bancorp's interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to Bancorp's position, this gap will work against Bancorp and Bancorp's 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; and
- international disorder and instability in domestic and foreign financial markets.

Bancorp's asset-liability management strategy, which is designed to mitigate Bancorp's risk from changes in market interest rates, may not be able to prevent changes in interest rates from having a material adverse effect on Bancorp's results of operations and financial condition.

**Competition with other financial institutions could adversely affect Bancorp's profitability.**

Bancorp faces 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, Bancorp encounters competition from both de novo and smaller community banks entering its markets. Bancorp also competes with other providers of financial services, such as brokerage firms, consumer finance companies and insurance companies. This competition may reduce or limit Bancorp's margins on banking services, reduce Bancorp's market share and adversely affect Bancorp's results of operations and financial condition.



**The unexpected loss of key members of Bancorp's management team may adversely affect Bancorp's operations.**

Bancorp's success to date has been influenced strongly by Bancorp's ability to attract and to retain senior management experienced in banking and financial services. Bancorp's ability to retain executive officers and the current management teams of each of Bancorp's lines of business will continue to be important to successful implementation of Bancorp's 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 Bancorp's business and financial results.

**Bancorp's profitability depends on local and national economic conditions.**

Bancorp's success depends on general economic conditions both locally and nationally. Most of Bancorp's customers are in the Louisville MSA with a growing number of customers in the Indianapolis and Cincinnati areas. Some of Bancorp's 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 Bancorp's customers for loans, the ability of some borrowers to repay these loans, and the value of the collateral securing these loans.

Loan growth and collectability are critical to Bancorp's profitability. Significant decline in general economic conditions will negatively affect the financial results of Bancorp's banking operations.

**If Bancorp's allowance for loan losses is not sufficient to cover actual loan losses, Bancorp's earnings could decrease.**

Bancorp's loan customers may not repay their loans according to the terms of these loans, and the collateral securing the payment of these loans may be insufficient to ensure repayment. Accordingly, Bancorp may experience significant credit losses which could have a material adverse effect on operating results. Management makes various assumptions and judgments about the collectability of Bancorp's loan portfolio, including the creditworthiness of Bancorp's borrowers and the value of real estate and other assets serving as collateral for repayment of many of Bancorp's loans. In determining the adequacy of the allowance for loan losses, management considers, among other factors, Bancorp's loan loss experience and an evaluation of economic conditions. Bancorp has continued to perform well facing a more challenging environment and has responded aggressively to work through loan problems; however, Bancorp will not remain immune from challenges that affect the economy as a whole. There has been a general weakening macroeconomic trend, particularly slumping housing market conditions and widespread signs of deteriorating credit quality. If Bancorp's assumptions prove to be incorrect, Bancorp's 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 Bancorp's loan portfolio. Material additions to Bancorp's allowance would materially decrease Bancorp's net income.

In addition, federal and state regulators periodically review Bancorp's allowance for loan losses and may require an increase in Bancorp's provision for loan losses or further loan charge-offs. Any increase in Bancorp's provision for loan losses or loan charge-offs as required by these regulatory agencies could have a negative effect on net income.

**Bancorp operates in a highly regulated environment and may be adversely affected by changes in federal and local laws and regulations.**

Bancorp is 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 Bancorp's bank and its operations. Additional legislation and regulations may be enacted or adopted in the future that could significantly affect Bancorp's powers, authority and operations, which could have a material adverse effect on Bancorp's 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 Bancorp's results of operations and financial condition.

**Item 1B. Unresolved Staff Comments**

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

**Item 2. Properties**

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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 ten branch properties at December 31, 2007 (two of which are located on leased land) and Bancorp owned three. 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, 2007, 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, 2007, for information relating to legal proceedings.

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

None

**Executive Officers of the Registrant**

The following table lists the names and ages (as of December 31, 2007) 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<br>of Executive Officer | Position and Offices<br>with Bank  |
|--------------------------------------|--|
| David P. Heintzman<br>Age 48         | Chairman, President and Chief Executive Officer                            |
| Kathy C. Thompson<br>Age 46          | Senior Executive Vice President and Director                               |
| Nancy B. Davis<br>Age 52             | Executive Vice President, Secretary, Treasurer and Chief Financial Officer |

Mr. Heintzman was appointed Chairman and Chief Executive Officer effective January 1, 2005. Prior thereto, he served as President of Bancorp and the Bank since 1992. Mr. Heintzman joined the Bank in 1985.

Ms. Thompson was appointed Senior Executive Vice President in January 2005. 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 and is also responsible for the sales, service and marketing areas of the Bank.

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 under the ticker symbol SYBT. Prior to July 2005, 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, 2007, Bancorp had 1,285 shareholders of record, and approximately 2,700 non-objecting beneficial owners holding shares in nominee or street name.

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| Quarter | 2007     |          |                         | 2006     |          |                         |
|---------|----------|----------|-------------------------|----------|----------|-------------------------|
|         | High     | Low      | Cash Dividends Declared | High     | Low      | Cash Dividends Declared |
| First   | \$ 28.50 | \$ 24.09 | \$ 0.15                 | \$ 25.16 | \$ 23.13 | \$ 0.13                 |
| Second  | 25.70    | 23.56    | 0.16                    | 28.28    | 24.15    | 0.14                    |
| Third   | 29.31    | 22.92    | 0.16                    | 30.03    | 25.55    | 0.15                    |
| Fourth  | 28.45    | 21.68    | 0.16                    | 29.54    | 27.55    | 0.15                    |

The following table shows information relating to the repurchase of shares of common stock by Bancorp during the three months ended December 31, 2007.

|                        | 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   | 171,500                          | \$ 26.43                     | 171,500   | 80,524  |
| November 1-November 30 | 130,624                          | 23.29                        | 130,624   | 499,900   |
| December 1-December 31 | 109,300                          | 23.63                        | 109,300   | 390,600   |
| <b>Total</b>           | 411,424                          | \$ 24.69                     | 411,424   | 390,600   |

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. That plan's expiration date is set for November 2008. In November 2007, as part of this stock repurchase program, the Company established a Rule 10b5-1 stock trading plan. As of December 31, 2007, 390,600 shares remain 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, 2002 and that all dividends were reinvested.

| Index                  | Period Ending |          |          |          |          |          |
|------------------------|---------------|----------|----------|----------|----------|----------|
|                        | 12/31/02      | 12/31/03 | 12/31/04 | 12/31/05 | 12/31/06 | 12/31/07 |
| S.Y. Bancorp, Inc.     | 100.00        | 112.55   | 134.21   | 142.12   | 170.64   | 149.67   |
| Russell 2000 Index     | 100.00        | 147.25   | 174.24   | 182.18   | 215.64   | 212.26   |
| SNL Midwest Bank Index | 100.00        | 128.00   | 144.44   | 139.18   | 160.87   | 125.39   |
| SNL NASDAQ Bank Index  | 100.00        | 129.08   | 147.94   | 143.43   | 161.02   | 126.42   |

## Item 6. Selected Financial Data

## Selected Consolidated Financial Data

| (Dollars in thousands except per share data)   | Years ended December 31 |            |            |            |           |
|--|-------------------------|------------|------------|------------|-----------|
|  | 2007                    | 2006       | 2005       | 2004       | 2003      |
| Net interest income                            | \$ 53,777               | \$ 53,886  | \$ 49,235  | \$ 44,221  | \$ 42,748 |
| Provision for loan losses                      | 3,525                   | 2,100      | 225        | 2,090      | 2,550     |
| Net income                                     | 24,052                  | 22,896     | 21,644     | 18,912     | 17,709    |
| <b>Per share data</b>                          |                         |            |            |            |           |
| Net income, basic                              | \$ 1.70                 | \$ 1.58    | \$ 1.48    | \$ 1.31    | \$ 1.25   |
| Net income, diluted                            | 1.67                    | 1.55       | 1.46       | 1.27       | 1.21      |
| Cash dividends declared                        | 0.63                    | 0.57       | 0.45       | 0.37       | 0.29      |
| Book value                                     | 9.78                    | 9.54       | 8.67       | 7.96       | 7.05      |
| Market value                                   | 23.94                   | 28.00      | 23.83      | 22.95      | 19.58     |
| <b>Average balances</b>                        |                         |            |            |            |           |
| Stockholders' equity                           | \$ 139,357              | \$ 131,971 | \$ 121,614 | \$ 109,414 | \$ 93,799 |
| Assets   | 1,413,614               | 1,353,651  | 1,270,178  | 1,148,652  | 1,083,949 |
| Federal Home Loan Bank advances                | 65,699                  | 34,466     | 25,809     | 25,573     |           |
| Long-term debt                                 | 93                      | 10,458     | 20,769     | 20,799     | 20,829    |
| <b>Selected ratios</b>                         |                         |            |            |            |           |
| Return on average assets                       | 1.70%                   | 1.69%      | 1.70%      | 1.65%      | 1.63%     |
| Return on average stockholders' equity         | 17.26                   | 17.35      | 17.80      | 17.28      | 18.88     |
| Average stockholders' equity to average assets | 9.86                    | 9.75       | 9.57       | 9.53       | 8.65      |
| Net interest rate spread                       | 3.48                    | 3.76       | 3.79       | 3.82       | 3.86      |
| Net interest rate margin, fully tax-equivalent | 4.16                    | 4.36       | 4.25       | 4.20       | 4.25      |
| Non-performing loans to total loans            | 0.28                    | 0.59       | 0.44       | 0.57       | 0.55      |
| Non-performing assets to total assets          | 0.49                    | 0.65       | 0.59       | 0.75       | 0.76      |
| Net charge offs to average loans               | 0.20                    | 0.18       | 0.07       | 0.15       | 0.29      |
| Allowance for loan losses to average loans     | 1.16                    | 1.12       | 1.19       | 1.37       | 1.38      |

Per share information has been adjusted to reflect 5% stock dividend effective May 2006 and 2-for-1 stock split effective September 2003.



**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, 2007, 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 a loan production office in Cincinnati, Ohio. In January 2008, the Cincinnati office moved into a permanent facility and converted to a full-service branch. 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

materially impact Bancorp's financial position and its results from operations. Additional information regarding income taxes is discussed in the Income Taxes section below and note 7 to the consolidated financial statements.

## Overview of 2007

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 2007, Bancorp completed its twentieth consecutive year of earnings per share increases. This achievement was particularly significant in light of ongoing margin pressure and deteriorating economic conditions throughout the year, which have restrained loan growth and had a significant impact on the financial sector's credit quality.

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 5% during 2007 to more than \$1.2 billion for the first time, and this was the driving force for growth in interest income. Increased loan volume helped to partially offset the increasing margin pressures the Bank has experienced. The average rate earned on assets increased slightly in 2007, despite downward pressure both from the Federal Reserve and competitors, as the rates earned on loans held steady since the average prime rate moved up slightly from 2006. Loan growth was funded by increased deposits and increased borrowings from the FHLB. As rates paid on liabilities increased more sharply than rates earned on assets, net interest income and net interest margin both decreased on a year to year basis.

Distinguishing Bancorp from other similarly sized community banks is its diverse revenue stream. Non-interest income as a percentage of total revenues was over 36% in 2007 and continued to be key to earnings growth. Stock Yards Trust Company maintained new business growth in 2007, and revenues increased accordingly. Also supporting the strong growth in total non-interest income were revenues from service charges on deposit accounts, bankcard transactions, brokerage activity, gains on sales of mortgage loans, bank owned life insurance and other various sources.

Also impacting 2007 net income, Bancorp:

- Increased the 2007 loan loss provision by \$1,425,000 to \$3,525,000 to address increasing risk in our portfolio related to prolonged economic weaknesses and the greater stress this places on borrowers.

- Accelerated its expansion activities with the addition of a second office in Indianapolis in late 2007 and hiring officers to open an office in Cincinnati in January 2008.
- Reduced its tax expense in 2007 for a correction to deferred tax liabilities of approximately \$648,000 and adjusted other tax-related balances to reflect finalization of its most recently filed tax returns, which related to prior years.
- Experienced net interest margin erosion as the Federal Reserve Board lowered rates in the second half of 2007 and loans indexed to the prime rate repriced immediately down with the rate changes.

Challenges for 2008 will include continued net interest margin erosion, loan growth and credit quality.

- The Federal Reserve Board continued to lower rates into 2008. Approximately 40% 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.

- Competition from other financial institutions both well established and newcomers results in loan and deposit pricing pressures.
- To achieve our goals for 2008, net loan growth must exceed that of 2007. 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.
- While the Bank has responded aggressively to work through loan problems as exhibited by year-end credit quality metrics, we are not immune from challenges that affect the economy as a whole. We will continue to monitor it closely, but credit quality could be a challenge in the coming year.

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

### **Results of Operations**

Net income was \$24,052,000 or \$1.67 per share on a diluted basis for 2007 compared to \$22,896,000 or \$1.55 per share for 2006 and \$21,644,000 or \$1.46 per share for 2005. Net income for 2007 was impacted by:

- A 0.2% decline in net interest income.
- A 67.9% increase in provision for loan losses.
- A 5.5% increase in non-interest income.
- A 0.2% decrease in non-interest expenses.
- A 9.6% decrease in income taxes.
- A 6.2 % repurchase of common stock.

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, is 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

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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)                    | 2007         | 2006         | 2005         | 2007/2006<br>Change | 2006/2005<br>Change |
|---|--------------|--------------|--------------|---------------------|---------------------|
| Net interest income, tax-equivalent basis | \$ 54,854    | \$ 54,912    | \$ 50,131    | (0.1)%              | 9.5%                |
| Net interest spread                       | 3.48%        | 3.76%        | 3.79%        | (28)bp              | (3)bp               |
| Net interest margin                       | 4.16%        | 4.36%        | 4.25%        | (20)bp              | 11bp                |
| Average earning assets                    | \$ 1,317,963 | \$ 1,258,591 | \$ 1,178,922 | 4.7%                | 6.8%                |
| Five year treasury bond at year end       | 3.45%        | 4.70%        | 4.36%        | (125)bp             | 34bp                |
| Average five year treasury bond           | 4.42%        | 4.75%        | 4.04%        | (33)bp              | 71bp                |
| Prime rate at year end                    | 7.25%        | 8.25%        | 7.25%        | (100)bp             | 100bp               |
| Average prime rate                        | 8.05%        | 7.96%        | 6.19%        | 9bp                 | 177bp               |

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 40% 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. Most of the Bank's fixed rate loans are priced in relation to the five year Treasury bond.

Average loan balances increased \$65 million or 6.0% in 2007; however, the competitive lending environment held average loan yields flat. Average interest costs on interest bearing deposits increased 36 basis points reflecting strong competition for deposits as Bancorp grew average interest bearing deposits \$20 million or 1.9%. To supplement deposit growth, Bancorp increased its average borrowings from the FHLB by \$31.2 million with average rates being lower than comparable certificate of deposit rates.

For 2008 management anticipates a declining prime rate and competitive pressures could further decrease the rate the Bank earns on loans. Similarly, contractual repricing coupled with 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, 2007 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 | 0.56  |
| Increase 100 bp | 0.28  |
| Decrease 100 bp | (0.24)                                      |
| Decrease 200 bp | (0.50)                                      |

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Based upon management's assessment of interest rate sensitivity, Bancorp had no derivative financial instruments during fiscal years 2007 or 2006.



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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 2007 and 2006 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     | 2007/2006<br>Increase (Decrease)<br>Due to |                 | Net Change      | 2006/2005<br>Increase (Decrease)<br>Due to |                 |  |
|---|----------------|--|-----------------|-----------------|--|-----------------|--|
|   |                | Rate                                       | Volume          |                 | Rate                                       | Volume          |  |
| <b>Interest income</b>  |                |  |                 |                 |  |                 |  |
| Loans   | \$ 4,826       | \$ 54                                      | \$ 4,772        | \$ 13,796       | \$ 8,434                                   | \$ 5,362        |  |
| Federal funds sold  | (33)           | 88   | (121)           | 462             | 288  | 174             |  |
| Mortgage loans held for sale  | (26)           | (4)  | (22)            | (83)            | 57   | (140)           |  |
| <b>Securities</b>   |                |  |                 |                 |  |                 |  |
| Taxable   | 483            | 424  | 59              | 149             | 55   | 94              |  |
| Tax-exempt  | (210)          | 40   | (250)           | (210)           | (15)                                       | (195)           |  |
| <b>Total interest income</b>  | <b>5,040</b>   | <b>602</b>                                 | <b>4,438</b>    | <b>14,114</b>   | <b>8,819</b>                               | <b>5,295</b>    |  |
| <b>Interest expense</b>   |                |  |                 |                 |  |                 |  |
| <b>Deposits</b>   |                |  |                 |                 |  |                 |  |
| Interest bearing demand deposits  | (169)          | 9  | (178)           | 329             | 599  | (270)           |  |
| Savings deposits  | (106)          | (78)                                       | (28)            | 66              | 69   | (3)             |  |
| Money market deposits   | 1,918          | 701  | 1,217           | 2,392           | 1,914                                      | 478             |  |
| Time deposits   | 2,254          | 2,017                                      | 237             | 5,667           | 3,350                                      | 2,317           |  |
| <b>Securities sold under agreements to repurchase and federal funds purchased</b> |                |  |                 |                 |  |                 |  |
|   | 574            | 377  | 197             | 838             | 827  | 11              |  |
| Other short-term borrowings   | (174)          | 20   | (194)           | 269             | 49   | 220             |  |
| Federal Home Loan Bank advances   | 1,734          | 272  | 1,462           | 694             | 406  | 288             |  |
| Long-term debt  | (933)          | (131)                                      | (802)           | (922)           | 5  | (927)           |  |
| <b>Total interest expense</b>   | <b>5,098</b>   | <b>3,187</b>                               | <b>1,911</b>    | <b>9,333</b>    | <b>7,219</b>                               | <b>2,114</b>    |  |
| <b>Net interest income</b>  | <b>\$ (58)</b> | <b>\$ (2,585)</b>                          | <b>\$ 2,527</b> | <b>\$ 4,781</b> | <b>\$ 1,600</b>                            | <b>\$ 3,181</b> |  |

Bancorp's net interest income decreased \$58,000 for the year ended December 31, 2007 compared to the same period of 2006 while 2006 compared to 2005 saw a \$4,781,000 increase. Net interest income for the year 2007 compared to 2006 was positively impacted by an increase in loan volume and a slight increase in the average rate earned on assets and negatively impacted by an increase in deposit and other borrowing rates. 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.

For the year 2006 compared to 2005, average loan rates accounted for \$8,434,000 of the increase in loan interest income, while growth generated an increase of \$5,362,000 in interest income. This increase was somewhat offset by volume in money market and time deposit growth, which increased interest expense by \$2,795,000 and volume impacted interest expense by \$5,264,000.



**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)              | 2007     | 2006     | 2005   |
|-------------------------------------|----------|----------|--------|
| Provision for loan losses           | \$ 3,525 | \$ 2,100 | \$ 225 |
| Allowance to loans at year end      | 1.12%    | 1.06%    | 1.14%  |
| Allowance to average loans for year | 1.16%    | 1.12%    | 1.19%  |

The provision for loan losses increased \$1,425,000 during 2007 compared to 2006 in response to Bancorp's assessment of inherent risk in the loan portfolio. Non-performing loans for the year declined over 50% from \$6,753,000 in 2006 to \$3,370,000 in 2007. The ratio of non-performing loans to total loans was 0.28% at December 31, 2007, down from 0.59% at December 31, 2006. Net charge-offs totaled 0.20% of average loans at year-end 2007, up slightly from 0.18% at year-end 2006. However, management believes these metrics do not yet reflect the effect of weakening macroeconomic trends, particularly the widespread effect of the slumping housing market conditions and other signs of deteriorating credit quality. Management considered these factors as it increased the provision for loan losses in 2007 as well increasing allocations related to construction and development, real estate mortgage and consumer loan categories. 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, 2007 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 2007, 2006 and 2005. The table shows the dollar and percentage change from 2006 to 2007 and from 2005 to 2006. Below the table is a discussion of significant changes and trends.

| (Dollars in thousands)                   | 2007      | 2006      | 2005      | 2007/2006 |        | 2006/2005 |       |
|--|-----------|-----------|-----------|-----------|--------|-----------|-------|
|  |           |           |           | Change    | %      | Change    | %     |
| <b>Non-interest income</b>               |           |           |           |           |        |           |       |
| Investment management and trust services | \$ 12,886 | \$ 11,632 | \$ 10,813 | \$ 1,254  | 10.8%  | \$ 819    | 7.6%  |
| Service charges on deposit accounts      | 8,758     | 8,791     | 8,426     | (33)      | (0.4)% | 365       | 4.3%  |
| Bankcard transaction revenue             | 2,359     | 2,028     | 1,704     | 331       | 16.3%  | 324       | 19.0% |

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|   |           |           |           |          |        |          |        |
|---|-----------|-----------|-----------|----------|--------|----------|--------|
| Gains on sales of mortgage loans held for sale  | 1,164     | 1,270     | 1,391     | (106)    | (8.3)% | (121)    | (8.7)% |
| Gains on sales of securities available for sale |           |           |           |          |        |          |        |
| Brokerage commissions and fees                  | 1,929     | 1,973     | 2,055     | (44)     | (2.2)% | (82)     | (4.0)% |
| Bank owned life insurance income                | 985       | 914       | 881       | 71       | 7.8%   | 33       | 3.7%   |
| Other   | 2,165     | 2,074     | 2,092     | 91       | 4.4%   | (18)     | (0.9)% |
|   | \$ 30,246 | \$ 28,682 | \$ 27,362 | \$ 1,564 | 5.5%   | \$ 1,320 | 4.8%   |

Total non-interest income increased 5.5% for the year ended December 31, 2007 compared to the same period for 2006. The largest component of non-interest income is investment management and trust services. This area of the Bank continues to grow through attraction of new business and customer retention. At

December 31, 2007 assets under management totaled \$1.7 billion compared to \$1.6 billion at December 31, 2006 and \$1.4 billion as of December 31, 2005. Because assets under management are expressed in terms of fair value, increases in market value of existing accounts during the last three years and the attraction of new business have both served to increase assets under management. Growth in the department's assets consisted primarily of personal trust accounts during both 2007 and 2006. 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 2007, 2006 and 2005 executor fees totaled approximately \$1,024,000, \$763,000 and \$730,000, respectively.

Service charges on deposit accounts decreased \$33,000 or 0.4%, for the year ended December 31, 2007 compared to the same period a year ago. The main factor that contributed to the decrease was lower non-sufficient fund fee activity in 2007.

Bankcard transaction revenue increased \$331,000 or 16.3% in 2007 compared to 2006 and primarily represents income that the Bank derives from customers' use of debit cards. As the popularity of these cards has grown, there have been increases in the number of transactions by cardholders as customers recognize the convenience that the cards offer.

The Bank operates a mortgage banking company. This division originates residential mortgage loans and sells the loans in the secondary market. Interest rates on the loans sold are locked with the buyer and investor, thus Bancorp bears no interest rate risk related to these loans. The division offers conventional, VA and FHA financing, as well as a program for low-income first time home buyers. Loans are made for both the purchase and refinancing of homes. The mortgage banking company also offers home equity conversion mortgages or reverse mortgages designed by the U.S. Department of Housing and Urban Development (HUD). These HUD loans give older homeowners a vehicle for turning equity in their homes to cash. Interest rates on conventional mortgage loans directly impact the volume of business transacted by the mortgage banking division. Higher rates in 2006 and the majority of 2007, coupled with a less favorable economy in general, slowed loan volume. Prior to August of 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 Federal National Mortgage Association (FNMA) with servicing rights retained.

Brokerage commissions and fees earned primarily from stock, bond and mutual fund sales decreased slightly during 2007 as overall transaction volume was down compared to the prior year. Turnover in brokerage positions throughout 2007 also negatively impacted income. 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 during 2007. BOLI generated income of \$985,000 and \$914,000 during 2007 and 2006, respectively. This income helps offset the rising cost of employee benefits.

Other non-interest income increased slightly during 2007 compared to 2006 partly as a result of an increase in fees derived from business internet banking services. Other non-interest income decreased slightly from 2006 compared to 2005 due to 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 2007, 2006 and 2005. The table shows the dollar and percentage change from 2006 to 2007 and from 2005 to 2006. Below the table is a discussion of significant changes and trends.

| (Dollars in thousands)   | 2007      | 2006      | 2005      | 2007/2006 |          | 2006/2005 |          |
|--|-----------|-----------|-----------|-----------|----------|-----------|----------|
|  |           |           |           | Change    | %        | Change    | %        |
| <b>Non-interest expense</b>  |           |           |           |           |          |           |          |
| Salaries and employee benefits   | \$ 27,002 | \$ 26,406 | \$ 24,544 | \$ 596    | 2.3%     | \$ 1,862  | 7.6%     |
| Net occupancy expense  | 3,722     | 3,480     | 3,444     | 242       | 7.0%     | 36        | 1.0%     |
| Data processing expense  | 4,043     | 3,834     | 3,668     | 209       | 5.5%     | 166       | 4.5%     |
| Furniture and equipment expense  | 1,148     | 1,152     | 1,191     | (4)       | (0.3)%   | (39)      | (3.3)%   |
| Amortization and write-off of issuance costs of trust preferred securities |           | 897       | 35        | (897)     | (100.0)% | 862       | 2,462.9% |
| State bank taxes   | 1,155     | 1,298     | 1,562     | (143)     | (11.0)%  | (264)     | (16.9)%  |
| Other  | 9,461     | 9,543     | 10,228    | (82)      | (0.9)%   | (685)     | (6.7)%   |
|  | \$ 46,531 | \$ 46,610 | \$ 44,672 | \$ (79)   | (0.2)%   | \$ 1,938  | 4.3%     |

Salaries and benefits are the largest component of non-interest expenses and increased \$596,000 or 2.3% for 2007 compared to 2006. As a result of revised standard costs applied to the loan production process and an increased volume, the Bank's deferred salaries associated with loan originations year-to-date 2007 exceeded those amounts in the same period last year. This helped offset a rise in salaries and employee benefits expense related in part to the addition of staff associated with the development of a second office in the Indianapolis market and the Bank's recent entry into the Cincinnati market. The Bank's employee levels increased slightly during 2007 compared to 2006. At December 31, 2007, the Bank had 446 full-time equivalent employees compared to 437 at the same date in 2006 and 442 for 2005. There are no obligations for post-retirement or post-employment benefits.

Additionally, Bancorp recognized \$467,000 and \$531,000 in stock option expense in 2007 and 2006 with the implementation of SFAS No. 123R compared to \$34,000 in 2005 when Bancorp accelerated the vesting of all employees' stock options. By vesting these stock options early, Bancorp avoided recognizing approximately \$1,000,000 in expense over what would have been future vesting periods of one to four years. See Note 15 to Bancorp's consolidated financial statements for further discussion of stock compensation.

Net occupancy expense has increased as the Bank has added banking centers. The Bank opened three locations in 2007, one location in 2006 and no locations in 2005. At December 31, 2007 the Bank had twenty-seven banking center locations including the main office.

Data processing expense rose as the Bank continues to update computer equipment and software to keep pace with technology advances. During 2007, the Bank placed a new mainframe computer and a new back-up system into service. 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-recurring 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 9.00% and were redeemed at par value. Unamortized issuance costs related to these instruments of \$879,000 were expensed at redemption.



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State bank taxes in Kentucky are based primarily on average capital and deposit levels. Bancorp purchased Commonwealth of Kentucky historic tax preservation credits at a discount to help reduce state bank tax in 2007 and 2006. Bancorp used state historic tax credits of approximately \$195,000 and \$145,000 to help reduce state bank tax during 2007 and 2006.

Various other non-interest expenses decreased slightly for the year ended December 31, 2007 compared to the same period of 2006 by \$82,000.

### Income Taxes

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

| (Dollars in thousands) | 2007     | 2006      | 2005      |
|------------------------|----------|-----------|-----------|
| Income tax expense     | \$ 9,915 | \$ 10,962 | \$ 10,056 |
| Effective tax rate     | 29.2%    | 32.4%     | 31.7%     |

The reduced level of income tax expense 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 the year, income tax expense declined \$1,047,000 or 10% to \$9,915,000 from \$10,962,000 in 2006, reflecting the aforementioned correction and adjustments. The increase in the effective tax rate in 2006 compared to 2005 was primarily due to decreasing proportion of municipal tax-exempt income and an increase in Indiana state income taxes due to growing operations in Indiana. 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)               | 2007         | 2006         | 2005         | 2007/2006<br>Change | %    | 2006/2005<br>Change | %    |
|--------------------------------------|--------------|--------------|--------------|---------------------|------|---------------------|------|
| Average earning assets               | \$ 1,317,963 | \$ 1,258,591 | \$ 1,178,922 | \$ 59,372           | 4.7% | \$ 79,669           | 6.8% |
| Average interest bearing liabilities | 1,064,754    | 1,018,620    | 954,726      | 46,134              | 4.5% | 63,894              | 6.7% |
| Average total assets                 | 1,413,614    | 1,353,651    | 1,270,178    | 59,963              | 4.4% | 83,473              | 6.6% |
| Total year end assets                | 1,482,219    | 1,426,321    | 1,330,438    | 55,898              | 3.9% | 95,883              | 7.2% |



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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 2007 to 2006, average loans increased 6.0%. More specifically, period end commercial and industrial loans increased 12.7%, construction loans increased 8.5%, owner occupied commercial real estate increased 12.2% and consumer loans decreased 24.3%. The Bank has targeted commercial and industrial loans as well as professional 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 the business customers as well as provide personal financial services to the business owners. During 2006, average loans increased 7.7% with growth being primarily from commercial and industrial loans and construction loans.

The increase in average interest bearing liabilities from 2006 to 2007 occurred primarily in money market deposits and time deposits spurred by deposit promotions to support loan growth. Total interest bearing accounts increased 2.5% and non-interest bearing accounts decreased 1.1%. The average cost of the interest bearing deposits rose to 3.4%, a 36 basis point increase from 3.1% for 2006. In addition, Bancorp continued to utilize fixed rate advances from the Federal Home Loan Bank during 2007 as they compared favorably to

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similar term time deposits. Bancorp had an average of \$65,699,000 in outstanding FHLB advances in 2007 compared to \$34,466,000 and \$25,809,000 in 2006 and 2005, respectively.

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

| (Dollars in thousands)                       | Year 2007           |               |              | Year 2006           |               |              | Year 2005           |               |              |
|--|---------------------|---------------|--------------|---------------------|---------------|--------------|---------------------|---------------|--------------|
|  | Average Balances    | Interest      | Average Rate | Average Balances    | Interest      | Average Rate | Average Balances    | Interest      | Average Rate |
| <b>Earning assets</b>                        |                     |               |              |                     |               |              |                     |               |              |
| Federal funds sold                           | \$ 18,212           | \$ 944        | 5.18%        | \$ 20,651           | \$ 977        | 4.73%        | \$ 16,057           | \$ 515        | 3.21%        |
| Mortgage loans held for sale                 | 3,372               | 225           | 6.67%        | 3,707               | 251           | 6.77%        | 5,902               | 334           | 5.66%        |
| <b>Securities</b>                            |                     |               |              |                     |               |              |                     |               |              |
| Taxable                                      | 105,785             | 4,675         | 4.42%        | 104,621             | 4,240         | 4.05%        | 102,509             | 4,126         | 4.03%        |
| Tax-exempt                                   | 27,756              | 1,538         | 5.54%        | 32,283              | 1,748         | 5.41%        | 35,895              | 1,958         | 5.45%        |
| FHLB stock                                   | 3,737               | 248           | 6.64%        | 3,485               | 200           | 5.74%        | 3,298               | 165           | 5.00%        |
| Loans, net of unearned income                | 1,159,101           | 84,763        | 7.31%        | 1,093,844           | 79,937        | 7.31%        | 1,015,261           | 66,141        | 6.51%        |
| <b>Total earning assets</b>                  | <b>1,317,963</b>    | <b>92,393</b> | <b>7.01%</b> | <b>1,258,591</b>    | <b>87,353</b> | <b>6.94%</b> | <b>1,178,922</b>    | <b>73,239</b> | <b>6.21%</b> |
| <b>Less allowance for loan losses</b>        |                     |               |              |                     |               |              |                     |               |              |
|  | 12,560              |               |              | 12,406              |               |              | 12,662              |               |              |
|  | <b>1,305,403</b>    |               |              | <b>1,246,185</b>    |               |              | <b>1,166,260</b>    |               |              |
| <b>Non-earning assets</b>                    |                     |               |              |                     |               |              |                     |               |              |
| Cash and due from banks                      | 33,305              |               |              | 34,680              |               |              | 34,485              |               |              |
| Premises and equipment                       | 25,056              |               |              | 25,063              |               |              | 25,913              |               |              |
| Accrued interest receivable and other assets | 49,850              |               |              | 47,723              |               |              | 43,520              |               |              |
| <b>Total assets</b>                          | <b>\$ 1,413,614</b> |               |              | <b>\$ 1,353,651</b> |               |              | <b>\$ 1,270,178</b> |               |              |

| (Dollars in thousands)  | Year 2007        |          |              | Year 2006        |          |              | Year 2005        |          |              |
|---|------------------|----------|--------------|------------------|----------|--------------|------------------|----------|--------------|
|   | 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</b>   |                  |          |              |                  |          |              |                  |          |              |
| demand deposits   | \$ 208,575       | \$ 2,990 | 1.43%        | \$ 221,019       | \$ 3,159 | 1.43%        | \$ 242,769       | \$ 2,830 | 1.17%        |
| Savings deposits  | 41,388           | 177      | 0.43%        | 46,382           | 283      | 0.61%        | 47,081           | 217      | 0.46%        |
| <b>Money market</b>   |                  |          |              |                  |          |              |                  |          |              |
| deposits  | 218,736          | 8,212    | 3.75%        | 185,152          | 6,294    | 3.40%        | 166,458          | 3,902    | 2.34%        |
| Time deposits   | 442,036          | 20,014   | 4.53%        | 436,288          | 17,760   | 4.07%        | 371,700          | 12,093   | 3.25%        |
| <b>Securities sold under agreements to repurchase and federal funds purchased</b> |                  |          |              |                  |          |              |                  |          |              |
|   | 86,248           | 2,869    | 3.33%        | 79,752           | 2,295    | 2.88%        | 79,170           | 1,457    | 1.84%        |
| <b>Other short-term borrowings</b>  |                  |          |              |                  |          |              |                  |          |              |
|   | 1,979            | 124      | 6.27%        | 5,103            | 298      | 5.84%        | 970              | 29       | 2.99%        |
| FHLB advances   | 65,699           | 3,146    | 4.79%        | 34,466           | 1,412    | 4.10%        | 25,809           | 718      | 2.78%        |
| Long-term debt  | 93               | 7        | 7.53%        | 10,458           | 940      | 8.99%        | 20,769           | 1,862    | 8.97%        |

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|  |              |        |       |              |        |       |              |        |       |
|--|--------------|--------|-------|--------------|--------|-------|--------------|--------|-------|
| Total interest bearing liabilities             | 1,064,754    | 37,539 | 3.53% | 1,018,620    | 32,441 | 3.18% | 954,726      | 23,108 | 2.42% |
| Non-interest bearing liabilities               |              |        |       |              |        |       |              |        |       |
| Non-interest bearing demand deposits           | 170,748      |        |       | 172,640      |        |       | 169,971      |        |       |
| Accrued interest payable and other liabilities | 38,755       |        |       | 30,420       |        |       | 23,867       |        |       |
| Total liabilities                              | 1,274,257    |        |       | 1,221,680    |        |       | 1,148,564    |        |       |
| Stockholders equity                            | 139,357      |        |       | 131,971      |        |       | 121,614      |        |       |
| Total liabilities and stockholders equity      | \$ 1,413,614 |        |       | \$ 1,353,651 |        |       | \$ 1,270,178 |        |       |
| Net interest income                            | \$ 54,854    |        |       | \$ 54,912    |        |       | \$ 50,131    |        |       |
| Net interest spread                            |              |        | 3.48% |              |        | 3.76% |              |        | 3.79% |
| Net interest margin                            |              |        | 4.16% |              |        | 4.36% |              |        | 4.25% |

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 \$1,077,000, \$1,026,000 and \$896,000 for the years ended December 31, 2007, 2006 and 2005, 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 \$453,000, \$1,039,000 and \$1,054,000 in 2007, 2006 and 2005, respectively.

**Securities**

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)   | 2007       | December 31<br>2006 | 2005       |
|--|------------|---------------------|------------|
| <b>Securities available for sale</b>                           |            |                     |            |
| U.S. Treasury and other U.S. government-sponsored corporations | \$ 119,819 | \$ 101,369          | \$ 105,188 |
| Mortgage-backed securities                                     | 11,313     | 13,801              | 19,619     |
| Obligations of states and political subdivisions               | 24,249     | 27,072              | 30,224     |
| Other  | 9,097      | 3,453               | 1,919      |
|  | \$ 164,478 | \$ 145,695          | \$ 156,950 |
| <b>Securities held to maturity</b>                             |            |                     |            |
| Mortgage-backed securities                                     | \$ 59      | \$ 89               | \$ 133     |
| Obligations of states and political subdivisions               | 1,070      | 3,059               | 3,991      |
|  | \$ 1,129   | \$ 3,148            | \$ 4,124   |

The maturity distribution and weighted average interest rates of securities at December 31, 2007, 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-sponsored corporations | \$ 44,848       | 4.15% | \$ 70,786                       | 4.66% | \$ 4,185                        | 5.01% |                 |       |
| Mortgage-backed securities                                     |                 |       | 3,134                           | 4.07% | 6,321                           | 3.93% | 1,858           | 5.67% |
| Obligations of states and political subdivisions               | 3,660           | 4.22% | 10,438                          | 5.41% | 10,151                          | 6.80% |                 |       |
| Other  |                 |       |                                 |       |                                 |       | 9,097           | 7.90% |
|  | \$ 48,508       | 4.15% | \$ 84,358                       | 4.73% | \$ 20,657                       | 5.56% | \$ 10,955       | 7.52% |
| <b>Securities held to maturity</b>                             |                 |       |                                 |       |                                 |       |                 |       |
| Mortgage-backed securities                                     | \$ 755          | 6.70% | \$ 315                          | 6.86% | \$ 26                           | 6.48% | \$ 33           | 6.44% |

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Obligations of states and political subdivisions

|  |    |     |       |    |     |       |    |    |       |    |    |       |
|--|----|-----|-------|----|-----|-------|----|----|-------|----|----|-------|
|  | \$ | 755 | 6.70% | \$ | 315 | 6.86% | \$ | 26 | 6.48% | \$ | 33 | 6.44% |
|--|----|-----|-------|----|-----|-------|----|----|-------|----|----|-------|

**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)               | 2007         | 2006         | December 31<br>2005 | 2004       | 2003       |
|------------------------------|--------------|--------------|---------------------|------------|------------|
| Commercial and industrial    | \$ 309,506   | \$ 274,599   | \$ 225,369          | \$ 215,755 | \$ 189,477 |
| Construction and development | 144,668      | 133,361      | 126,961             | 82,261     | 53,506     |
| Real estate mortgage:        |              |              |                     |            |            |
| Commercial                   | (a)          | (a)          | (a)                 | 336,382    | 299,654    |
| Commercial investment        | 240,610      | 242,742      | 219,852             | (a)        | (a)        |
| Owner occupied commercial    | 200,122      | 178,439      | 151,651             | (a)        | (a)        |
| 1-4 family residential       | 145,362      | 150,285      | 153,252             | 201,109    | 200,956    |
| Home equity                  | 136,962      | 136,893      | 140,287             | 116,053    | 99,184     |
| Consumer                     | 24,708       | 32,635       | 36,499              | 33,281     | 43,376     |
|                              | \$ 1,201,938 | \$ 1,148,954 | \$ 1,053,871        | \$ 984,841 | \$ 886,153 |

(a) In 2006 the Company changed its methodology 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 2003, 2004 and 2005.

The following tables detail the amounts of commercial and industrial loans, and construction and development loans at December 31, 2007, 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)               | Within one year | Maturing                           |                  | Total      |
|------------------------------|-----------------|------------------------------------|------------------|------------|
|                              |                 | After one but<br>within five years | After five years |            |
| Commercial and industrial    | \$ 102,852      | \$ 135,821                         | \$ 70,833        | \$ 309,506 |
| Construction and development | 65,408          | 63,754                             | 15,506           | 144,668    |

| (In thousands)                      | Interest Sensitivity |               |
|-------------------------------------|----------------------|---------------|
|                                     | Fixed rate           | Variable rate |
| Due after one but within five years | \$ 91,589            | \$ 44,232     |
| Due after five years                | 52,597               | 18,236        |
|                                     | \$ 144,186           | \$ 62,468     |

**Non-performing Loans and Assets**

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

| (Dollars in thousands)  | 2007     | 2006     | December 31<br>2005 | 2004     | 2003     |
|---|----------|----------|---------------------|----------|----------|
| Non-accrual loans   | \$ 2,964 | \$ 5,900 | \$ 3,709            | \$ 4,944 | \$ 4,417 |
| Loans past due 90 days or more and still accruing                 | 406      | 853      | 891                 | 696      | 433      |
| Non-performing loans  | 3,370    | 6,753    | 4,600               | 5,640    | 4,850    |
| Foreclosed real estate  | 3,831    | 2,466    | 3,226               | 3,284    | 3,633    |
| Other foreclosed property   |          |          | 40                  | 113      |          |
| Non-performing assets   | \$ 7,201 | \$ 9,219 | \$ 7,866            | \$ 9,037 | \$ 8,483 |
| Non-performing loans as a percentage of total loans               | 0.28%    | 0.59%    | 0.44%               | 0.57%    | 0.55%    |
| Non-performing assets as a percentage of total assets             | 0.49%    | 0.65%    | 0.59%               | 0.75%    | 0.76%    |
| Allowance for loan losses as a percentage of non-performing loans | 399%     | 181%     | 262%                | 222%     | 243%     |

Non-performing loans as a percentage of total loans decreased 31 basis points compared to the prior year. This decrease was partially the result of charging off one loan of \$800,000 in 2007 that was included in the December 2006 non-accrual total. 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 \$55,000, \$164,000, and \$127,000 for 2007, 2006, and 2005, respectively. Interest income that would have been recorded if non-accrual loans were on a current basis in accordance with their original terms was \$241,000, \$554,000, and \$382,000 for 2007, 2006, and 2005, respectively.

In addition to the non-performing loans discussed above, there were loans for which payments were current or less than 90 days past due where borrowers are experiencing significant financial difficulties. These loans totaled approximately \$4,028,000, \$5,110,000, and \$6,211,000 at December 31, 2007, 2006, and 2005, 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 16 basis points from 2006 to 2007. The decrease in non-performing assets as a percentage of total assets was the result of the decrease in non-performing loans. Foreclosed real estate primarily consists of a residential subdivision development that has required several years for full disposition due to the nature of the property. This asset is periodically evaluated for impairment and no impairment charges have been deemed necessary.

**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 may partially charge a loan down to net realizable value.



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 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.

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.

### Summary of Loan Loss Experience

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 |              |              |            |            |
|---|------------------------|--------------|--------------|------------|------------|
|   | 2007                   | 2006         | 2005         | 2004       | 2003       |
| Average loans   | \$ 1,159,101           | \$ 1,093,844 | \$ 1,015,261 | \$ 913,502 | \$ 853,299 |
| Balance of allowance for loan losses at beginning of year | \$ 12,203              | \$ 12,035    | \$ 12,521    | \$ 11,798  | \$ 11,705  |
| Loans charged off   |                        |              |              |            |            |
| Commercial and industrial                                 | 1,695                  | 920          | 300          | 703        | 467        |
| Construction and development                              | 42                     | 703          |              |            | 986        |
| Real estate mortgage                                      | 547                    | 298          | 241          | 583        | 690        |
| Consumer  | 827                    | 853          | 822          | 793        | 1,071      |
| Total loans charged off                                   | 3,111                  | 2,774        | 1,363        | 2,079      | 3,214      |
| Recoveries of loans previously charged off                |                        |              |              |            |            |
| Commercial and industrial                                 | 242                    | 59           | 207          | 236        | 115        |
| Construction and development                              |                        | 23           |              |            |            |
| Real estate mortgage                                      | 65                     | 237          | 78           | 11         | 254        |
| Consumer  | 526                    | 523          | 367          | 465        | 388        |
| Total recoveries  | 833                    | 842          | 652          | 712        | 757        |
| Net loans charged off                                     | 2,278                  | 1,932        | 711          | 1,367      | 2,457      |
| Additions to allowance charged to expense                 | 3,525                  | 2,100        | 225          | 2,090      | 2,550      |
| Balance at end of year                                    | \$ 13,450              | \$ 12,203    | \$ 12,035    | \$ 12,521  | \$ 11,798  |
| Ratio of net charge-offs during year to average loans     | 0.20%                  | 0.18%        | 0.07%        | 0.15%      | 0.29%      |

The overall increase in charge-offs during 2007 can be attributed one large borrower in the commercial and industrial portfolio that involved fraudulent collateral. The principal balance of this loan was specifically allocated to the allowance for loan losses and the Bank fully charged off the loan in the first quarter of 2007. 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.

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| (In thousands)               | 2007      | 2006      | December 31<br>2005 | 2004      | 2003      |
|------------------------------|-----------|-----------|---------------------|-----------|-----------|
| Commercial and industrial    | \$ 1,991  | \$ 2,385  | \$ 3,762            | \$ 4,366  | \$ 4,085  |
| Construction and development | 876       | 340       | 744                 | 687       | 1,887     |
| Real estate mortgage         | 3,421     | 2,851     | 2,712               | 2,500     | 1,598     |
| Consumer                     | 3,444     | 2,579     | 2,074               | 2,011     | 1,571     |
| Unallocated                  | 3,718     | 4,048     | 2,743               | 2,957     | 2,657     |
|                              | \$ 13,450 | \$ 12,203 | \$ 12,035           | \$ 12,521 | \$ 11,798 |

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 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:

|                              | 2007   | 2006   | December 31<br>2005 | 2004   | 2003   |
|------------------------------|--------|--------|---------------------|--------|--------|
| Commercial and industrial    | 25.8%  | 23.9%  | 21.4%               | 21.9%  | 21.4%  |
| Construction and development | 12.0%  | 11.6%  | 12.0%               | 8.3%   | 6.0%   |
| Real estate mortgage         | 48.7%  | 49.7%  | 49.8%               | 54.6%  | 56.5%  |
| Consumer                     | 13.5%  | 14.8%  | 16.8%               | 15.2%  | 16.1%  |
|                              | 100.0% | 100.0% | 100.0%              | 100.0% | 100.0% |

Selected ratios relating to the allowance for loan losses follow:

|   | 2007  | Years ended December 31<br>2006 | 2005  |
|---|-------|---------------------------------|-------|
| Provision for loan losses to average loans  | 0.30% | 0.20%                           | 0.02% |
| Net charge-offs to average loans            | 0.20% | 0.18%                           | 0.07% |
| Allowance for loan losses to average loans  | 1.16% | 1.12%                           | 1.19% |
| Allowance for loan losses to year end loans | 1.12% | 1.06%                           | 1.14% |



## 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:

| (Dollars in thousands)               | Years ended December 31 |              |                 |              |                 |              |
|--------------------------------------|-------------------------|--------------|-----------------|--------------|-----------------|--------------|
|                                      | 2007                    |              | 2006            |              | 2005            |              |
|                                      | Average Balance         | Average Rate | Average Balance | Average Rate | Average Balance | Average Rate |
| Non-interest bearing demand deposits | \$ 170,748              |              | \$ 172,640      |              | \$ 169,971      |              |
| Interest bearing demand deposits     | 208,575                 | 1.43%        | 221,019         | 1.43%        | 242,769         | 1.17%        |
| Savings deposits                     | 41,388                  | 0.43%        | 46,382          | 0.61%        | 47,081          | 0.46%        |
| Money market deposits                | 218,736                 | 3.75%        | 185,152         | 3.40%        | 166,458         | 2.34%        |
| Time deposits                        | 442,036                 | 4.53%        | 436,288         | 4.07%        | 371,700         | 3.25%        |
|                                      | \$ 1,081,483            |              | \$ 1,061,481    |              | \$ 997,979      |              |

Maturities of time deposits of \$100,000 or more outstanding at December 31, 2007, are summarized as follows:

| (In thousands)           | Amount     |
|--------------------------|------------|
| 3 months or less         | \$ 34,489  |
| Over 3 through 6 months  | 30,412     |
| Over 6 through 12 months | 58,114     |
| Over 12 months           | 22,862     |
|                          | \$ 145,877 |

## 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:

Years ended December 31

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| (Dollars in thousands)                         | 2007      |       | 2006      |       | 2005      |       |
|--|-----------|-------|-----------|-------|-----------|-------|
|  | Amount    | Rate  | Amount    | Rate  | Amount    | Rate  |
| Securities sold under agreements to repurchase |           |       |           |       |           |       |
| Year end                                       | \$ 81,205 | 2.79% | \$ 84,313 | 2.87% | \$ 79,886 | 2.17% |
| Average during year                            | 83,775    | 3.27% | 78,028    | 2.82% | 78,360    | 1.83% |
| Maximum month end balance during year          | 95,295    |       | 84,313    |       | 87,987    |       |



### **Subordinated Debentures**

Subordinated debentures are classified as long term debt. 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. Bancorp funded the redemption by borrowing \$20 million on a line of credit from a correspondent bank. During the third quarter of 2006, the Bank declared and paid a dividend of \$20 million to Bancorp allowing Bancorp to pay off the \$20 million line of credit. The interest rate on the trust preferred securities was fixed at 9.00%. The lower cost of funds had a positive impact in net interest spread and margin, which somewhat offset the rising cost of deposits. 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 to meet the demand is provided by maturing assets, short-term liquid assets that can be converted to cash and the ability to attract funds from external sources, principally depositors. Management prefers to focus on transaction accounts and full service relationships with customers.

Bancorp's Asset/Liability Committee is primarily comprised 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 Bank has a number of sources of funds to meet liquidity needs on a daily basis. Our core deposit base, including consumer and commercial deposits, are a principal source of funds. The majority of these deposits come from long-term customers and is a stable source of liquidity. The Bank has no brokered deposits.

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 Federal Home Loan Bank of Cincinnati (FHLB). 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, 2007, the amount of available credit from the FHLB totaled \$10 million. Bancorp's ability to borrow from the FHLB has been reduced by the Bank's use of fixed rate advances and standby letters of credit. Bancorp is exploring avenues to expand its borrowing capacity with the FHLB by offering additional types of collateral. See Note 10 for further information regarding advances from the Federal Home Loan Bank. Also, the Bank has federal funds purchased lines with correspondent banks totaling \$58 million. 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 at any time. Bancorp can also borrow from the Federal Reserve Bank of St. Louis based upon its asset size.

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 if January 1, of any year, the Bank may pay dividends up to the total of 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

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securities, the Bank needed and obtained approval for its first quarter 2007 and 2008 dividends. 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. 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.

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, 2007 are as follows:

| (In thousands)            | Total      | Amount of Commitment Expiration per Period |              |              |                 |
|---------------------------|------------|--|--------------|--------------|-----------------|
|                           |            | Less than<br>1 year                        | 1-3<br>Years | 3-5<br>Years | Over 5<br>Years |
| Unused loan commitments   | \$ 341,190 | \$ 143,022                                 | \$ 69,899    | \$ 54,820    | \$ 73,449       |
| Standby letters of credit | 19,414     | 11,030                                     | 8,181        | 201          | 2               |

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, Note 14 and Note 17 to Bancorp's consolidated financial statements for further information on the time deposits, Federal Home Loan Bank advances, subordinated debentures and the defined benefit retirement plan.

The required payments under such commitments at December 31, 2007 are as follows:

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| (In thousands)                  | Total     | Payments due by period |              |              |                 |
|---------------------------------|-----------|------------------------|--------------|--------------|-----------------|
|                                 |           | Less than<br>1 year    | 1-3<br>Years | 3-5<br>Years | Over 5<br>Years |
| Operating leases                | \$ 10,233 | \$ 1,356               | \$ 2,081     | \$ 1,954     | \$ 4,842        |
| Defined benefit retirement plan | 4,737     | 174                    | 327          | 247          | 3,989           |
| Federal Home Loan Bank advances | 90,000    | 20,000                 | 50,000       | 20,000       |                 |
| Subordinated debentures         | 90        |                        |              |              | 90              |
| Time deposits                   | 423,385   | 342,869                | 69,370       | 10,654       | 492             |

As of December 31, 2007, the Company has unrecognized tax benefits that, if recognized, would impact the effective tax rate in future periods. Due to the uncertainty of the amounts to be ultimately paid as well as the timing of such payments, all uncertain tax liabilities that have not been paid have been excluded from the table above. Further detail on the impact of income taxes is located in Note 7 of Bancorp's consolidated financial statements.

## Capital

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

| (Dollars in thousands, except share data) | Years ended December 31 |            |            |
|---|-------------------------|------------|------------|
|   | 2007                    | 2006       | 2005       |
| Stockholders' equity                      | \$ 133,024              | \$ 137,444 | \$ 125,797 |
| Dividends per share                       | \$ 0.63                 | \$ 0.57    | \$ 0.45    |
| Tier 1 risk-based capital                 | 9.82%                   | 11.69%     | 13.44%     |
| Total risk-based capital                  | 10.82%                  | 12.73%     | 14.56%     |
| Leverage ratio                            | 9.21%                   | 10.16%     | 11.15%     |

The decrease in stockholders' equity from 2006 to 2007 was primarily due to the acceleration 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 2005, July 2007 and November 2007, the Directors expanded this plan to provide additional shares for repurchase. The plan's expiration date is set for November 2008. As of December 31, 2007 there remained 390,600 shares yet to be purchased under the program. During 2007, the Company repurchased a total of 886,600 shares of common stock, or 6% of its outstanding shares as of January 1, 2007, at an average price of \$25.20 per share. These share repurchases helped leverage the Company's earnings growth on a per share basis, adding approximately \$0.04 per share for the year, not considering the opportunity costs on funds used for the buyback. S.Y. Bancorp also increased its cash payout to stockholders during 2007, raising the annual dividend 10.5% to \$0.63 per share, or an annual yield of 2.7% when annualizing the fourth quarter dividend rate and considering the year-end closing stock price.

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 decline in capital ratios from 2006 to 2007 resulted largely from the stock repurchase activities. Note 19 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 (loss) was \$83,000 and \$(1,013,000) at December 31, 2007 and 2006, respectively. The \$1,096,000 change is primarily a reflection of the effect of the changing interest rate environment during fiscal year 2007 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 |        |        |
|--|-------------------------|--------|--------|
|  | 2007                    | 2006   | 2005   |
| Return on average assets                   | 1.70%                   | 1.69%  | 1.70%  |
| Return on average stockholders' equity     | 17.26%                  | 17.35% | 17.80% |
| Dividend pay out ratio, based on basic EPS | 37.06%                  | 36.00% | 30.13% |

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|  |       |       |       |
|--|-------|-------|-------|
| Average stockholders' equity to average assets | 9.86% | 9.75% | 9.57% |
|--|-------|-------|-------|

### Recently Issued Accounting Pronouncements

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements*. This statement is definitional and disclosure oriented and addresses how companies should approach measuring fair value when required by Generally Accepted Accounting Principals ( GAAP ); it does not create or modify any current GAAP requirements to apply fair value accounting. The Standard provides a single definition for fair value that is to be applied consistently for all accounting applications, and also generally describes and prioritizes according to reliability the methods and inputs used in valuations. 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 new measurement and disclosure requirements of FASB Statement No. 157 are effective for fiscal years beginning after November 15, 2007. On December 14, 2007, the FASB issued proposed FASB Staff Position 157-b which would delay the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. This proposed staff position partially defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008. The adoption of FASB Statement No. 157 in 2008 is not expected to have a material impact on Bancorp s consolidated financial statements.

In February 2007, the FASB issued FASB Statement 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. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reporting earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company s choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The new Statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosure about fair value measurements included in FASB Statements No. 157, *Fair Value Measurements* and No. 107, *Disclosures about Fair Value of Financial Instruments*. This Statement is effective for fiscal years beginning after November 15, 2007. The adoption of FASB No. 159 in 2008 is not expected to have a material impact on Bancorp s consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes ( FIN 48 )*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized under SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in the tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 did not have an impact on Bancorp s consolidated financial statements.

**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, 2007 and 2006

Consolidated Statements of Income years ended December 31, 2007, 2006 and 2005

Consolidated Statements of Changes in Stockholders' Equity years ended December 31, 2007, 2006 and 2005

Consolidated Statements of Comprehensive Income years ended December 31, 2007, 2006 and 2005

Consolidated Statements of Cash Flows years ended December 31, 2007, 2006 and 2005

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

Management's Report on Consolidated Financial Statements



**Consolidated Balance Sheets**

| (Dollars in thousands)   | December 31,        |                     |
|--|---------------------|---------------------|
|  | 2007                | 2006                |
| <b>Assets</b>  |                     |                     |
| Cash and due from banks  | \$ 38,907           | \$ 44,007           |
| Federal funds sold   | 422                 | 15,671              |
| Mortgage loans held for sale   | 4,771               | 4,035               |
| Securities available for sale (amortized cost \$163,927 in 2007 and \$146,859 in 2006)   | 164,478             | 145,695             |
| Securities held to maturity (fair value \$1,128 in 2007 and \$3,159 in 2006)   | 1,129               | 3,148               |
| Federal Home Loan Bank stock   | 3,931               | 3,591               |
| Loans  | 1,201,938           | 1,148,954           |
| Less allowance for loan losses   | 13,450              | 12,203              |
| Net loans  | 1,188,488           | 1,136,751           |
| Premises and equipment   | 27,195              | 24,823              |
| Bank owned life insurance  | 23,122              | 22,137              |
| Accrued interest receivable  | 6,516               | 6,917               |
| Other assets   | 23,260              | 19,546              |
| <b>Total assets</b>  | <b>\$ 1,482,219</b> | <b>\$ 1,426,321</b> |
| <b>Liabilities</b>   |                     |                     |
| Deposits   |                     |                     |
| Non-interest bearing   | \$ 170,477          | \$ 179,657          |
| Interest bearing   | 936,230             | 923,585             |
| Total deposits   | 1,106,707           | 1,103,242           |
| Securities sold under agreements to repurchase and federal funds purchased   | 108,699             | 84,313              |
| Other short-term borrowings  | 10,665              | 734                 |
| Accrued interest payable   | 1,092               | 829                 |
| Other liabilities  | 31,942              | 39,639              |
| Federal Home Loan Bank advances  | 90,000              | 60,000              |
| Subordinated debentures  | 90                  | 120                 |
| <b>Total liabilities</b>   | <b>1,349,195</b>    | <b>1,288,877</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 13,599,563 shares in 2007 and 14,400,420 shares in 2006 | 6,214               | 8,878               |
| Additional paid-in capital   | 9,821               | 27,703              |
| Retained earnings  | 116,906             | 101,876             |
| Accumulated other comprehensive income (loss)  | 83                  | (1,013)             |
| <b>Total stockholders equity</b>   | <b>133,024</b>      | <b>137,444</b>      |
| <b>Total liabilities and stockholders equity</b>   | <b>\$ 1,482,219</b> | <b>\$ 1,426,321</b> |

See accompanying notes to consolidated financial statements.



## Consolidated Statements of Income

| (In thousands, except per share data)                                      | Years Ended December 31, |                  |                  |
|--|--------------------------|------------------|------------------|
|  | 2007                     | 2006             | 2005             |
| <b>Interest income</b>   |                          |                  |                  |
| Loans  | \$ 84,149                | \$ 79,437        | \$ 65,835        |
| Federal funds sold   | 944                      | 977              | 515              |
| Mortgage loans held for sale   | 225                      | 251              | 334              |
| Securities   |                          |                  |                  |
| Taxable  | 4,923                    | 4,440            | 4,291            |
| Tax-exempt   | 1,075                    | 1,222            | 1,368            |
| <b>Total interest income</b>   | <b>91,316</b>            | <b>86,327</b>    | <b>72,343</b>    |
| <b>Interest expense</b>  |                          |                  |                  |
| Deposits   | 31,393                   | 27,496           | 19,042           |
| Securities sold under agreements to repurchase and federal funds purchased | 2,869                    | 2,295            | 1,457            |
| Other short-term borrowings  | 124                      | 298              | 29               |
| Federal Home Loan Bank advances  | 3,146                    | 1,412            | 718              |
| Subordinated debentures  | 7                        | 940              | 1,862            |
| <b>Total interest expense</b>  | <b>37,539</b>            | <b>32,441</b>    | <b>23,108</b>    |
| <b>Net interest income</b>   | <b>53,777</b>            | <b>53,886</b>    | <b>49,235</b>    |
| Provision for loan losses  | 3,525                    | 2,100            | 225              |
| <b>Net interest income after provision for loan losses</b>                 | <b>50,252</b>            | <b>51,786</b>    | <b>49,010</b>    |
| <b>Non-interest income</b>   |                          |                  |                  |
| Investment management and trust services                                   | 12,886                   | 11,632           | 10,813           |
| Service charges on deposit accounts  | 8,758                    | 8,791            | 8,426            |
| Bankcard transaction revenue   | 2,359                    | 2,028            | 1,704            |
| Gains on sales of mortgage loans held for sale                             | 1,164                    | 1,270            | 1,391            |
| Gains on sales of securities available for sale                            |                          |                  |                  |
| Brokerage commissions and fees   | 1,929                    | 1,973            | 2,055            |
| Bank owned life insurance income   | 985                      | 914              | 881              |
| Other  | 2,165                    | 2,074            | 2,092            |
| <b>Total non-interest income</b>   | <b>30,246</b>            | <b>28,682</b>    | <b>27,362</b>    |
| <b>Non-interest expense</b>  |                          |                  |                  |
| Salaries and employee benefits   | 27,002                   | 26,406           | 24,544           |
| Net occupancy expense  | 3,722                    | 3,480            | 3,444            |
| Data processing expense  | 4,043                    | 3,834            | 3,668            |
| Furniture and equipment expense  | 1,148                    | 1,152            | 1,191            |
| Amortization and write-off of issuance costs of trust preferred securities |                          | 897              | 35               |
| State bank taxes   | 1,155                    | 1,298            | 1,562            |
| Other  | 9,461                    | 9,543            | 10,228           |
| <b>Total non-interest expense</b>  | <b>46,531</b>            | <b>46,610</b>    | <b>44,672</b>    |
| <b>Income before income taxes</b>  | <b>33,967</b>            | <b>33,858</b>    | <b>31,700</b>    |
| Income tax expense   | 9,915                    | 10,962           | 10,056           |
| <b>Net income</b>  | <b>\$ 24,052</b>         | <b>\$ 22,896</b> | <b>\$ 21,644</b> |
| <b>Net income per share, basic</b>   | <b>\$ 1.70</b>           | <b>\$ 1.58</b>   | <b>\$ 1.48</b>   |
| <b>Net income per share, diluted</b>                                       | <b>\$ 1.67</b>           | <b>\$ 1.55</b>   | <b>\$ 1.46</b>   |

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Changes in Stockholders' Equity

| (In thousands, except per share data)                                   | Common Stock     |          | Three Years Ended December 31, 2007 |                   |   |            | Total |
|---|------------------|----------|-------------------------------------|-------------------|---|------------|-------|
|   | Number of Shares | Amount   | Additional Paid-in Capital          | Retained Earnings | Accumulated Other Comprehensive Income (Loss) |            |       |
| Balance December 31, 2004   | 13,949           | \$ 7,373 | \$ 18,684                           | \$ 90,170         | \$ 420  | \$ 116,647 |       |
| Net income  |                  |          |                                     | 21,644            |   | 21,644     |       |
| Change in other comprehensive loss, net of tax                          |                  |          |                                     |                   | (1,617)                                       | (1,617)    |       |
| Non-cash compensation expense from vesting of stock options, net of tax |                  |          | 34                                  |                   |   | 34         |       |
| Shares issued for stock options exercised and employee benefit plans    | 101              | 337      | 772                                 |                   |   | 1,109      |       |
| Cash dividends, \$0.45 per share  |                  |          |                                     | (6,524)           |   | (6,524)    |       |
| Shares repurchased  | (234)            | (779)    | (4,717)                             |                   |   | (5,496)    |       |
| 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 income, 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  | (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  | (886)            | (2,955)  | (19,414)                            |                   |   | (22,369)   |       |
| Balance December 31, 2007   | 13,600           | \$ 6,214 | \$ 9,821                            | \$ 116,906        | \$ 83   | \$ 133,024 |       |

See accompanying notes to consolidated financial statements.



**Consolidated Statements of Comprehensive Income**

| (In thousands)   | Years Ended December 31 |           |           |
|--|-------------------------|-----------|-----------|
|  | 2007                    | 2006      | 2005      |
| <b>Net income</b>  | \$ 24,052               | \$ 22,896 | \$ 21,644 |
| Other comprehensive income (loss), net of tax:   |                         |           |           |
| Unrealized gains (losses) on securities available for sale:  |                         |           |           |
| Unrealized holding gains (losses) arising during the period (net of tax of \$601, \$92, and \$(899), respectively) | 1,114                   | 165       | (1,669)   |
| Minimum pension liability adjustment (net of tax of \$(9), \$10, and \$28, respectively)                           | (18)                    | 19        | 52        |
| Other comprehensive income (loss)  | 1,096                   | 184       | (1,617)   |
| <b>Comprehensive income</b>  | \$ 25,148               | \$ 23,080 | \$ 20,027 |

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Cash Flows

| (In thousands)   | Years Ended December 31 |                 |                  |
|--|-------------------------|-----------------|------------------|
|  | 2007                    | 2006            | 2005             |
| <b>Operating activities</b>  |                         |                 |                  |
| Net income   | \$ 24,052               | \$ 22,896       | \$ 21,644        |
| Adjustments to reconcile net income to net cash provided by operating activities:          |                         |                 |                  |
| Provision for loan losses  | 3,525                   | 2,100           | 225              |
| Depreciation, amortization and accretion, net  | 2,496                   | 2,981           | 3,257            |
| Amortization and write-off of debt issuance costs  |                         | 897             | 35               |
| Provision for deferred income taxes (benefit)  | (1,548)                 | (37)            | (56)             |
| Gains on sales of securities available for sale  |                         |                 |                  |
| Gains on sales of mortgage loans held for sale   | (1,164)                 | (1,270)         | (1,391)          |
| Loss on the disposal of equipment  | 15                      | 56              | 115              |
| Loss (gain) on the sale of other real estate   | 67                      | (62)            | 43               |
| Increase in value of bank owned life insurance   | (985)                   | (914)           | (881)            |
| Origination of mortgage loans held for sale  | (90,474)                | (80,563)        | (115,962)        |
| Proceeds from sales of mortgage loans held for sale  | 90,902                  | 85,242          | 115,437          |
| Non cash compensation expense from early vesting of stock options, net of tax              |                         |                 | 34               |
| Stock compensation expense   | 467                     | 531             |                  |
| Income tax benefit of stock options exercised  |                         |                 | 260              |
| Excess tax benefit from share-based compensation arrangements                              | (53)                    | (83)            |                  |
| Increase in accrued interest receivable and other assets                                   | (2,550)                 | (4,851)         | (3,283)          |
| (Decrease) increase in accrued interest payable and other liabilities                      | (7,423)                 | 9,728           | 9,371            |
| <b>Net cash provided by operating activities</b>   | <b>17,327</b>           | <b>36,651</b>   | <b>28,848</b>    |
| <b>Investing activities</b>  |                         |                 |                  |
| Purchases of securities available for sale   | (98,202)                | (65,348)        | (84,062)         |
| Proceeds from sales of securities available for sale                                       |                         |                 |                  |
| Proceeds from maturities of securities available for sale                                  | 80,802                  | 76,653          | 50,497           |
| Proceeds from maturities of securities held to maturity                                    | 2,015                   | 972             | 1,164            |
| Net increase in loans  | (61,253)                | (95,945)        | (70,963)         |
| Purchases of premises and equipment  | (4,887)                 | (2,749)         | (2,257)          |
| Proceeds from the sale of premises and equipment   |                         | 138             |                  |
| Proceeds from sales of other real estate   | 6,090                   | 2,603           | 1,363            |
| <b>Net cash used in investing activities</b>   | <b>(75,435)</b>         | <b>(83,676)</b> | <b>(104,258)</b> |
| <b>Financing activities</b>  |                         |                 |                  |
| Net increase in deposits   | 3,465                   | 71,885          | 81,274           |
| Net increase in securities sold under agreements to repurchase and federal funds purchased | 24,386                  | 4,427           | 6,602            |
| Net increase (decrease) in other short-term borrowings                                     | 9,931                   | (1,405)         | 963              |
| Repayments of subordinated debentures  | (30)                    | (20,649)        | (30)             |
| Repayments of Federal Home Loan Bank advances  | (10,000)                | (10,000)        | (10,000)         |
| Proceeds from Federal Home Loan Bank advances  | 40,000                  | 30,000          | 20,000           |
| Issuance of common stock for options and employee benefit plans                            | 1,193                   | 1,539           | 851              |
| Excess tax benefits from share-based compensation arrangements                             | 53                      | 83              |                  |
| Common stock repurchases   | (22,369)                | (5,271)         | (5,496)          |
| Cash dividends paid  | (8,870)                 | (7,945)         | (6,262)          |
| <b>Net cash provided by financing activities</b>   | <b>37,759</b>           | <b>62,664</b>   | <b>87,902</b>    |
| <b>Net (decrease) increase in cash and cash equivalents</b>                                | <b>(20,349)</b>         | <b>15,639</b>   | <b>12,492</b>    |
| <b>Cash and cash equivalents at beginning of year</b>                                      | <b>59,678</b>           | <b>44,039</b>   | <b>31,547</b>    |



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|   |    |        |    |        |    |        |
|---|----|--------|----|--------|----|--------|
| <b>Cash and cash equivalents at end of year</b> | \$ | 39,329 | \$ | 59,678 | \$ | 44,039 |
| <b>Supplemental cash flow information:</b>      |    |        |    |        |    |        |
| Income tax payments                             | \$ | 10,275 | \$ | 9,645  | \$ | 10,305 |
| Cash paid for interest                          |    | 37,376 |    | 32,189 |    | 22,891 |
| <b>Supplemental non-cash activity:</b>          |    |        |    |        |    |        |
| Transfers from loans to other real estate owned | \$ | 5,991  | \$ | 1,070  | \$ | 1,222  |

See accompanying notes to consolidated financial statements.

## 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 subsidiary, Stock Yards Bank & Trust Company (the Bank). Significant intercompany transactions and accounts have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to the 2007 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 ( U.S. 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 would be 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 August of 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

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. 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. Generally, 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. See Note 14.

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, 2007 and 2006,

other real estate owned totaled \$3,831,000 and \$2,466,000, respectively.

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

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, 2007, the 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. Management does not anticipate significant adjustments to the total amount of unrecognized tax benefits within the next twelve months.

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 shares that would be issued upon exercise of dilutive options, assuming proceeds are used to repurchase shares pursuant to the treasury stock method. As applicable, earnings per share amounts have been adjusted to reflect the May 2006 5% stock dividend.

### **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-seven full service banking locations as of December 31, 2007. 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

Prior to January 1, 2006, Bancorp used the intrinsic value method as described in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB No. 25 ) to measure stock-based compensation. Under the intrinsic value method, compensation expense was measured as the difference between the market value of the underlying shares and the price the employee is required to pay on the grant date, if any. Since Bancorp granted options at the current value of shares as of date of grant, no compensation expense was recorded.

On January 1, 2006, Bancorp adopted the modified version of prospective application of Statement of Financial Statement 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.

See Footnote 15 for further information on stock-based compensation.

### (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 \$838,000 and \$12,670,000 at December 31, 2007 and 2006, respectively.

### (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, 2007</b>                                       |                   |          |                      |            |
| U.S. Treasury and other U.S. government-sponsored corporations | \$ 119,529        | \$ 500   | \$ 210               | \$ 119,819 |
| Mortgage-backed securities                                     | 11,420            | 44       | 151                  | 11,313     |
| Obligations of states and political subdivisions               | 23,794            | 550      | 95                   | 24,249     |
| Other  | 9,184             |          | 87                   | 9,097      |
|  | \$ 163,927        | \$ 1,094 | \$ 543               | \$ 164,478 |
| <b>December 31, 2006</b>                                       |                   |          |                      |            |
| U.S. Treasury and other U.S. government-sponsored corporations | \$ 102,648        | \$ 29    | \$ 1,308             | \$ 101,369 |
| Mortgage-backed securities                                     | 14,131            | 61       | 391                  | 13,801     |



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|  |            |        |          |            |
|--|------------|--------|----------|------------|
| Obligations of states and political subdivisions | 26,830     | 541    | 299      | 27,072     |
| Other  | 3,250      | 203    |          | 3,453      |
|  | \$ 146,859 | \$ 834 | \$ 1,998 | \$ 145,695 |

Other consists of preferred securities of other bank holding companies and a domestic private investment fund.

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

| (In thousands)                                   | Amortized Cost | Gains | Unrealized Losses | Fair Value |
|--|----------------|-------|-------------------|------------|
| <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   |
| <b>December 31, 2006</b>                         |                |       |                   |            |
| Mortgage-backed securities                       | \$ 89          | \$ 2  | \$ 1              | \$ 90      |
| Obligations of states and political subdivisions | 3,059          | 10    |                   | 3,069      |
|  | \$ 3,148       | \$ 12 | \$ 1              | \$ 3,159   |

A summary securities as of December 31, 2007 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 Available for Sale |                        | Securities Held to Maturity |            |
|---------------------------------------|-------------------------------|------------------------|-----------------------------|------------|
|                                       | Amortized Cost                | Approximate Fair Value | Amortized Cost              | Fair Value |
| Due within one year                   | \$ 48,537                     | \$ 48,509              | \$ 755                      | \$ 756     |
| Due after one year through five years | 84,039                        | 84,358                 | 315                         | 312        |
| Due after five year through ten years | 20,345                        | 20,657                 | 26                          | 27         |
| Due after ten years                   | 11,006                        | 10,954                 | 33                          | 33         |
|                                       | \$ 163,927                    | \$ 164,478             | \$ 1,129                    | \$ 1,128   |

Securities with a carrying value of approximately \$108,610,000 at December 31, 2007 and \$103,666,000 at December 31, 2006 were pledged to secure the accounts of commercial depositors in cash management accounts, public deposits and certain borrowings.

At year end 2007 and 2006, 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, 2007 and 2006, 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, 2007</b>                                       |                     |                   |                   |                   |                  |                   |
| U.S. Treasury and other U.S. government-sponsored corporations | \$ 2,269            | \$                | \$ 32,549         | \$ 210            | \$ 34,818        | \$ 210            |
| Mortgage-backed securities                                     |                     |                   | 10,188            | 151               | 10,188           | 151               |
| Obligations of states and political subdivisions               |                     |                   | 7,979             | 95                | 7,979            | 95                |
| Other  | 3,162               | 87                |                   |                   | 3,162            | 87                |
| <b>Total temporarily impaired securities</b>                   | <b>\$ 5,431</b>     | <b>\$ 87</b>      | <b>\$ 50,716</b>  | <b>\$ 456</b>     | <b>\$ 56,147</b> | <b>\$ 543</b>     |
| <b>December 31, 2006</b>                                       |                     |                   |                   |                   |                  |                   |
| U.S. Treasury and other U.S. government-sponsored corporations | \$ 5,522            | \$ 65             | \$ 63,143         | \$ 1,243          | \$ 68,665        | \$ 1,308          |
| Mortgage-backed securities                                     |                     |                   | 12,624            | 391               | 12,624           | 391               |
| Obligations of states and political subdivisions               | 318                 | 1                 | 9,430             | 298               | 9,748            | 299               |
| <b>Total temporarily impaired securities</b>                   | <b>\$ 5,840</b>     | <b>\$ 66</b>      | <b>\$ 85,197</b>  | <b>\$ 1,932</b>   | <b>\$ 91,037</b> | <b>\$ 1,998</b>   |

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 52 and 69 separate investment positions as of December 31, 2007 and 2006 that are not considered other-than-temporarily impaired.

**(4) Loans**

The composition of loans follows:

| (In thousands)               | December 31,        |                     |
|------------------------------|---------------------|---------------------|
|                              | 2007                | 2006                |
| Commercial and industrial    | \$ 309,506          | \$ 274,599          |
| Construction and development | 144,668             | 133,361             |
| Real estate mortgage:        |                     |                     |
| Commercial investment        | 240,610             | 242,742             |
| Owner occupied commercial    | 200,122             | 178,439             |
| 1-4 family residential       | 145,362             | 150,285             |
| Home equity                  | 136,962             | 136,893             |
| Consumer                     | 24,708              | 32,635              |
|                              | <b>\$ 1,201,938</b> | <b>\$ 1,148,954</b> |

Loan balances include net deferred loan fees of \$162,000 at December 31, 2007 and \$983,000 at December 31, 2006. 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

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encompasses Louisville, Kentucky and surrounding communities including southern Indiana along with Indianapolis, Indiana and Cincinnati, Ohio.

**Information about impaired loans follows:**

| (In thousands)                             | 2007     | December 31, | 2006  |
|--|----------|--------------|-------|
| Principal balance of impaired loans        | \$ 2,964 | \$           | 5,900 |
| Impaired loans with a valuation allowance  | 1,857    |              | 3,547 |
| Amount of valuation allowance              | 717      |              | 989   |
| Impaired loans with no valuation allowance | 1,107    |              | 2,353 |
| Average balance of impaired loans for year | 4,120    |              | 5,290 |

Interest income on impaired or non-accrual loans (cash basis) was \$55,000, \$164,000 and \$127,000 in 2007, 2006, and 2005, respectively. Interest income that would have been recorded if non-accrual loans were on a current basis in accordance with their original terms was \$241,000, \$554,000 and \$382,000 in 2007, 2006 and 2005, 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 \$406,000 in 2007 and \$853,000 in 2006.

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)                   | 2007     | Year Ended December 31, | 2006   |
|---|----------|-------------------------|--------|
| <b>Balance as of January 1</b>  | \$ 8,007 | \$                      | 6,246  |
| New loans   | 47,299   |                         | 44,170 |
| Repayments  | 49,497   |                         | 42,409 |
| <b>Balance as of December 31</b>  | \$ 5,809 | \$                      | 8,007  |
| <b>Deposit balances of directors and executive officers as of December 31</b> | \$ 1,810 | \$                      | 1,611  |

An analysis of the changes in the allowance for loan losses for the years ended December 31, 2007, 2006, and 2005 follows:

| (In thousands)              | 2007      | Year Ended December 31, | 2006    | 2005      |
|-----------------------------|-----------|-------------------------|---------|-----------|
| <b>Balance at January 1</b> | \$ 12,203 | \$                      | 12,035  | \$ 12,521 |
| Provision for loan losses   | 3,525     |                         | 2,100   | 225       |
| Loans charged off           | (3,111)   |                         | (2,774) | (1,363)   |

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|                               |           |           |           |
|-------------------------------|-----------|-----------|-----------|
| Recoveries                    | 833       | 842       | 652       |
| Net loan charge-offs          | (2,278)   | (1,932)   | (711)     |
| <b>Balance at December 31</b> | \$ 13,450 | \$ 12,203 | \$ 12,035 |

**(5) Premises and Equipment**

A summary of premises and equipment follows:

| (In thousands)                            | December 31, |           |
|---|--------------|-----------|
|   | 2007         | 2006      |
| Land                                      | \$ 4,586     | \$ 4,586  |
| Buildings and improvements                | 24,519       | 21,518    |
| Furniture and equipment                   | 16,428       | 16,866    |
| Construction in progress                  | 886          | 1,083     |
|   | 46,419       | 44,053    |
| Accumulated depreciation and amortization | (19,224)     | (19,230)  |
|   | \$ 27,195    | \$ 24,823 |

Depreciation expense related to premises and equipment was \$2,500,000 in 2007, \$2,914,000 in 2006 and \$3,221,000 in 2005.

**(6) Other Assets**

A summary of the major components of other assets follows:

| (In thousands)   | December 31, |           |
|--|--------------|-----------|
|  | 2007         | 2006      |
| Cash surrender value of life insurance other than BOLI | \$ 7,120     | \$ 3,507  |
| Other real estate owned and other foreclosed property  | 3,831        | 2,466     |
| Net deferred tax asset                                 | 5,379        | 4,423     |
| Goodwill   | 682          | 682       |
| Tax credit investments                                 | 1,831        | 3,002     |
| Other  | 4,417        | 5,466     |
|  | \$ 23,260    | \$ 19,546 |

**(7) Income Taxes**

Income taxes consist of the following:

| (In thousands)  | Year Ended December 31, |               |               |
|---|-------------------------|---------------|---------------|
|   | 2007                    | 2006          | 2005          |
| <b>Expense (benefit) applicable to operations:</b>      |                         |               |               |
| Current   | \$ 11,463               | \$ 10,999     | \$ 10,112     |
| Deferred  | (1,548)                 | (37)          | (56)          |
| <b>Total applicable to operations</b>                   | <b>9,915</b>            | <b>10,962</b> | <b>10,056</b> |
| <b>Charged (credited) to stockholders equity:</b>       |                         |               |               |
| Unrealized gain (loss) on securities available for sale | 601                     | 92            | (899)         |
| Stock options exercised                                 | (53)                    | (83)          | (260)         |
| Minimum pension liability adjustment                    | (9)                     | 10            | 28            |
|   | \$ 10,454               | \$ 10,981     | \$ 8,925      |

An analysis of the difference between the federal statutory rate of 35% and effective tax rates follows:

|  | Year Ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2007                    | 2006         | 2005         |
| U.S. federal income tax rate           | 35.0%                   | 35.0%        | 35.0%        |
| Tax exempt interest income             | (2.3)%                  | (2.5)%       | (2.3)%       |
| Tax credits                            | (2.9)%                  | (0.8)%       | (0.5)%       |
| Cash surrender value of life insurance | (1.6)%                  | (1.2)%       | (1.4)%       |
| Other, net                             | 1.0%                    | 1.9%         | 0.9%         |
|  | <b>29.2%</b>            | <b>32.4%</b> | <b>31.7%</b> |



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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)                        | December 31,    |                 |
|---------------------------------------|-----------------|-----------------|
|                                       | 2007            | 2006            |
| <b>Deferred tax assets</b>            |                 |                 |
| Allowance for loan losses             | \$ 4,827        | \$ 4,220        |
| Deferred compensation                 | 2,118           | 1,804           |
| Other                                 | 189             | 174             |
| <b>Total deferred tax assets</b>      | <b>7,134</b>    | <b>6,198</b>    |
| <b>Deferred tax liabilities</b>       |                 |                 |
| Securities                            | 1,041           | 262             |
| Property and equipment                | 481             | 597             |
| Tax credits                           |                 | 648             |
| Other                                 | 233             | 268             |
| <b>Total deferred tax liabilities</b> | <b>1,755</b>    | <b>1,775</b>    |
| <b>Net deferred tax asset</b>         | <b>\$ 5,379</b> | <b>\$ 4,423</b> |

No valuation allowance for deferred tax assets was recorded as of December 31, 2007 and 2006 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 January 1, 2007, the gross amount of unrecognized tax benefits was \$311,000.

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 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 penalties was \$31,000 and at December 31, 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)

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

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)                   | December 31, |            |
|----------------------------------|--------------|------------|
|                                  | 2007         | 2006       |
| Interest bearing demand          | \$ 208,327   | \$ 218,869 |
| Savings                          | 38,758       | 42,036     |
| Money market                     | 265,760      | 199,904    |
| Time deposits greater than \$100 | 145,877      | 161,735    |
| Other time deposits              | 277,508      | 301,041    |
|                                  | \$ 936,230   | \$ 923,585 |

Interest expense related to certificates of deposit and other time deposits in denominations of \$100,000 or more was \$6,904,000, \$6,276,000, and \$3,915,000, respectively, for the years ended December 31, 2007, 2006 and 2005.

At December 31, 2007, the scheduled maturities of time deposits were as follows:

| (In thousands) |            |
|----------------|------------|
| 2008           | \$ 342,869 |
| 2009           | 50,037     |
| 2010           | 19,333     |
| 2011           | 4,989      |
| 2012           | 5,665      |
| Thereafter     | 492        |
|                | \$ 423,385 |

**(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) | December 31, |      |
|------------------------|--------------|------|
|                        | 2007         | 2006 |

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|   |    |        |    |        |
|---|----|--------|----|--------|
| Average balance during the year           | \$ | 83,775 | \$ | 78,028 |
| Average interest rate during the year     |    | 3.27%  |    | 2.82%  |
| Maximum month-end balance during the year | \$ | 95,295 | \$ | 84,313 |

Also, Bancorp has a \$20,000,000 line of credit with a local correspondent bank. As of December 31, 2007, the outstanding balance of this line was \$8,900,000. The line matures on July 3, 2008 and interest is paid quarterly at a rate of prime minus 190 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 an additional \$10 million, as of December 31, 2007, 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 \$90,000,000, at December 31, 2007, via four separate advances. The first two are fixed rate, non-callable advances of \$20,000,000 and \$30,000,000. The third advance of \$20,000,000 is a fixed rate advance eligible to be called by the FHLB after 12 months, in December of 2008, and then quarterly going forward until its maximum maturity in December of 2010. The fourth advance of \$20,000,000 is a fixed rate advance eligible to be called by the FHLB after 12 months, in May of 2008, and then quarterly going forward until its maximum maturity in May of 2012. The Bank had three fixed rate non-callable advances under this agreement totaling \$60,000,000 as of December 31, 2006. 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, 2007 |        | December 31, 2006 |        |       |
|----------------|-------------------|--------|-------------------|--------|-------|
|                | Advance           | Rate   | Advance           | Rate   |       |
| 2007           | \$                |        | \$                | 10,000 | 2.73% |
| 2008           |                   | 20,000 |                   | 20,000 | 4.83% |
| 2009           |                   | 30,000 |                   | 30,000 | 5.02% |
| 2010           |                   | 20,000 |                   |        | 3.69% |
| 2011           |                   |        |                   |        |       |
| 2012           |                   | 20,000 |                   |        | 4.58% |
|                | \$                | 90,000 | \$                | 60,000 | 4.58% |

The Bank also has a standby letter of credit from the FHLB for \$35 million outstanding at December 31, 2007. 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 \$100,000 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.

#### (11) Subordinated Debentures

On June 1, 2001, S.Y. Bancorp Capital Trust I, a Delaware statutory business trust and 100%-owned finance subsidiary of Bancorp, issued \$20.0 million of 9.00% Cumulative Trust Preferred Securities ( Securities ). The principal asset of the Trust I was a \$20.0 million subordinated debenture of Bancorp, and Bancorp owned all of the common securities of the Trust. The securities and subordinated debenture bore interest at the rate of 9.00% and would have matured June 30, 2031, subject to prior redemption under certain circumstances. The Securities, the assets of the Trust, and the common securities issued by the Trust were redeemable in whole or in part on or after June 30, 2006, or at any time in whole, but not in part, from the date of issuance upon the occurrence of certain events. The Securities were included in Tier 1 capital for regulatory capital adequacy determination purposes, subject to certain limitations. 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.

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.

The Bank had subordinated debentures outstanding amounting to \$90,000 at December 31, 2007 and \$120,000 at December 31, 2006. Interest due on these debentures is at a variable rate and for 2007 and 2006 was 7.25% and 6.25%, respectively. While the debentures mature in 2049,

the owner may redeem the debentures at any time.

**(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, 2007.

### (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)                    | 2007      | 2006      | 2005      |
|--|-----------|-----------|-----------|
| Net income, basic and diluted                            | \$ 24,052 | \$ 22,896 | \$ 21,644 |
| Average shares outstanding for basic EPS calculation     | 14,168    | 14,462    | 14,583    |
| Effect of dilutive securities                            | 221       | 279       | 238       |
| Average shares outstanding including dilutive securities | 14,389    | 14,741    | 14,821    |
| Net income per share, basic                              | \$ 1.70   | \$ 1.58   | \$ 1.48   |
| Net income per share, diluted                            | \$ 1.67   | \$ 1.55   | \$ 1.46   |

In April 2006, Bancorp declared a 5% stock dividend payable in May 2006. Share and per share information has been adjusted as appropriate for this dividend.

### (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 2007, 2006, and 2005 were \$1,224,000, \$929,000, and \$933,000, respectively. Employee and employer contributions are made in accordance with the terms of the plan. As of December 31, 2007 and 2006, the KSOP held 369,392 and 388,599, 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 \$60,000 and \$190,000 to the senior officers plan in 2007 and 2006. There were no contributions to this plan in 2005. At December 31, 2007 and 2006, the amounts included in other liabilities in the consolidated financial statements for this plan were \$2,072,000 and \$1,808,000. 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, 2007 and 2006, the accumulated benefit obligation for the plan included in other liabilities in the consolidated financial statements was \$1,993,000 and \$2,055,000, respectively. A discount rate of 5.75% was used in 2007 and 2006 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 for which will help 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, 2007 and 2006.





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

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

The following table sets forth the plan's benefit obligations and funded status at December 31, 2007 and 2006:

| (Dollars in thousands)                                     | 2007     | 2006     |
|--|----------|----------|
| <b>Pension benefits</b>                                    |          |          |
| Benefit obligation at December 31                          | \$ 1,993 | \$ 2,055 |
| Fair value of plan assets at December 31                   |          |          |
| Funded status  | (1,993)  | (2,055)  |
| Liability accrued in the consolidated financial statements | \$ 1,993 | \$ 2,055 |

The following table sets forth additional information concerning the plan as of December 31, 2007 and 2006:

| (Dollars in thousands)  | 2007   | 2006   |
|-------------------------|--------|--------|
| <b>Pension benefits</b> |        |        |
| Benefit cost            | \$ 134 | \$ 139 |
| Employer contribution   |        |        |
| Employee contribution   |        |        |
| Benefits paid           | 174    | 174    |

The benefits expected to be paid in each year from 2008 to 2012 are \$174,000, \$174,000, \$153,000, \$124,000 and \$123,000, respectively. The aggregate benefits expected to be paid beyond 2012 are \$3,989,000. The expected benefits to be paid are based on the same assumptions used to measure the Bank's benefit obligation at December 31, 2007.

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

### (15) Stock-Based Compensation

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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 31, 2007, there were 401,090 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. Under both plans options 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. All outstanding options 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. Restricted shares granted to

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executive officers are subject to a three-year vesting schedule. Certain other officers received grants vesting over two to five years.

As a result of applying the provisions of SFAS No. 123R, Bancorp recognized, within salaries and employee benefits in the consolidated income statement, stock-based compensation expense of \$467,000 and \$531,000 before income taxes and a deferred tax benefit of \$163,000 and \$186,000 resulting in a reduction of net income of \$304,000 and \$345,000, or \$0.02 per basic and diluted shares for the years ended December 31, 2007 and 2006, respectively. As of December 31, 2007 Bancorp has \$1,021,000 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 \$84,000 of unrecognized stock-based compensation expense that will be recorded over the next 2.25 years, the weighted average remaining life of the restricted shares. Bancorp received cash of \$1,193,000 and \$1,539,000 from the exercise of options during 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.

Had 2005 compensation cost for Bancorp's stock-based compensation plan been determined using the fair value method as described in SFAS No. 123, Bancorp's net income and earnings per share for the year ended December 31, 2005 would have approximated the pro forma amounts indicated as follows:

| (In thousands, except per share data)                                    | 2005             |
|--|------------------|
| Net income, as reported  | \$ 21,644        |
| Plus non-cash compensation expense recorded                              | 34               |
| Less stock-based compensation expense determined under fair value method | 1,439            |
| <b>Pro forma net income</b>  | <b>\$ 20,239</b> |
| <b>Basic EPS:</b>  |                  |
| As reported  | \$ 1.48          |
| Pro forma  | 1.39             |
| <b>Diluted EPS:</b>  |                  |
| As reported  | 1.46             |
| Pro forma  | 1.37             |

Under SFAS No. 123, Bancorp recognized actual forfeitures as they occurred within the above pro forma income calculation. 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. 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:



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|   | 2007   | 2006   | 2005   |
|---|--------|--------|--------|
| <b>Assumptions Used in Option Valuation</b> |        |        |        |
| Dividend yield                              | 1.81%  | 1.63%  | 1.56%  |
| Expected volatility                         | 14.49% | 16.53% | 16.60% |
| Risk free interest rate                     | 4.69%  | 4.42%  | 4.13%  |
| Forfeitures                                 | 5.55%  | 5.69%  |        |
| Expected life of options (in years)         | 7.7    | 7.7    | 7.0    |

The expected life of options 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 of 7.7 years for options granted during 2007 and 2006.

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

| (In thousands, except per share data) | Options | Exercise Price  | Weighted Average Exercise Price | Aggregate Intrinsic Value | Weighted Average Fair Value | Weighted Average Remaining Contractual Life in Years |
|---------------------------------------|---------|-----------------|---------------------------------|---------------------------|-----------------------------|--|
| <b>At December 31, 2006</b>           |         |                 |                                 |                           |                             |  |
| Vested and exercisable                | 818     | \$ 6.90-\$24.07 | \$ 17.13                        | \$ 14,009                 | \$ 3.64                     |  |
| Unvested                              | 139     | 18.05-24.07     | 23.89                           | 3,322                     | 5.76                        |  |
| Total outstanding                     | 957     | 6.90-24.07      | 18.12                           | 17,331                    | 3.95                        |  |
| Granted                               | 153     | 24.02-26.83     | 26.81                           | 4,098                     | 6.14                        |  |
| Exercised                             | (82)    | 6.90-24.07      | 14.29                           | (1,172)                   | 2.88                        |  |
| Forfeited                             | (12)    | 20.95-26.83     | 24.89                           | (299)                     | 5.89                        |  |
| <b>At December 31, 2007</b>           |         |                 |                                 |                           |                             |  |
| Vested and exercisable                | 800     | 9.76-26.83      | 18.10                           | 14,485                    | 3.90                        | 5.13   |
| Unvested                              | 216     | 18.05-26.83     | 25.42                           | 5,473                     | 5.96                        | 8.59   |
| Total outstanding                     | 1,016   | 9.76-26.83      | 19.65                           | \$ 19,958                 | 4.34                        | 5.86   |
| Vested during the year                | 67      | 18.05-26.83     | 25.41                           | \$ 1,707                  | 5.94                        |  |

The intrinsic value of stock options exercised in 2007, 2006 and 2005 was \$928,000, \$953,000 and \$1,532,000, respectively. The intrinsic value of stock options exercised was based on the closing price of Bancorp's common shares on the date of exercise.

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The weighted average fair values of options granted in 2007, 2006 and 2005 were \$6.14, \$5.81 and \$5.13, respectively.

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The Board of Directors of Bancorp accelerated the vesting of all unvested employee stock options outstanding on December 31, 2005. Accordingly, Bancorp recognized \$34,000 of compensation expense in the fourth quarter of 2005 based on an estimate of costs of those awards that would have expired unexercisable pursuant to original terms using a forfeiture rate based on historical experience. By vesting these stock options early, Bancorp avoided recognizing approximately \$1,000,000 in expense over what would have been future vesting periods of one to four years.

Options outstanding at December 31, 2007 were as follows:

(In thousands, except per share data)

| Option price per share | Expiration | Number of options outstanding | Options exercisable | Weighted average exercise price of options outstanding |
|------------------------|------------|-------------------------------|---------------------|--|
| \$ 9.76                | 2008       | 10                            | 10                  | \$ 9.76  |
| 11.40                  | 2009       | 46                            | 46                  | 11.40  |
| 9.82-10.00             | 2010       | 141                           | 141                 | 9.90   |
| 16.00                  | 2011       | 116                           | 116                 | 16.00  |
| 18.62                  | 2012       | 107                           | 107                 | 18.62  |
| 18.05-20.17            | 2013       | 111                           | 110                 | 20.13  |
| 20.25-22.81            | 2014       | 155                           | 153                 | 22.68  |
| 20.70-20.90            | 2015       | 2                             | 1                   | 20.83  |
| 24.07                  | 2016       | 180                           | 80                  | 24.07  |
| 24.02-26.83            | 2017       | 148                           | 36                  | 26.81  |
|                        |            | 1,016                         | 800                 | \$ 19.65   |

### (16) Dividend Restriction

Bancorp's principal source of funds is dividends received from the Bank. On January 1 of any year, the Bank's regulatory dividend restriction represents the total of 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.

### (17) Commitments and Contingent Liabilities

As of December 31, 2007, the Bank had various commitments and contingent liabilities outstanding that arose in the normal course of business, such as standby letters of credit and commitments to extend credit, which are not reflected in the consolidated financial statements. In management's opinion, commitments to extend credit of \$360,604,000, including standby letters of credit of \$19,414,000, represent normal banking transactions, and no significant losses are anticipated to result therefrom. This total is comprised largely of unused lines of credit for business and consumer customers, as well as unfunded portions of construction and development loans. The Bank's maximum exposure to credit loss in the event of nonperformance by the other party to these commitments is represented by the contractual amount of these instruments. The Bank uses the same credit and collateral policies in making commitments and conditional guarantees as for on-balance sheet instruments. At December 31, 2007, no amounts have been recorded in the consolidated financial statements relating to these instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. 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. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained,



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if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, properties and securities.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. Standby letters of credit generally have maturities of up to five years.

The Bank leases certain facilities, improvements and equipment under non-cancelable operating leases. Future minimum lease commitments for these leases are \$1,356,000 in 2008; \$1,067,000 in 2009; \$1,014,000 in 2010; \$994,000 in 2011; \$960,000 in 2012 and \$4,842,000 in the aggregate thereafter. Rent expense, net of sublease income, was \$1,422,000 in 2007, \$1,361,000 in 2006, and \$1,290,000 in 2005.

Also, as of December 31, 2007, there were pending legal actions and proceedings in which claims for damages are asserted. Management, after discussion with legal counsel, believes the ultimate result of these legal actions and proceedings will not have a material adverse effect on the consolidated financial position or results of operations of Bancorp.

### (18) Fair Value of Financial Instruments

The estimated fair values of financial instruments at December 31 are as follows:

| (In thousands)                                 | 2007               |              | 2006               |              |
|--|--------------------|--------------|--------------------|--------------|
|  | Carrying<br>Amount | Fair Value   | Carrying<br>Amount | Fair Value   |
| <b>Financial assets</b>                        |                    |              |                    |              |
| Cash and short-term investments                | \$ 39,329          | \$ 39,329    | \$ 59,678          | \$ 59,678    |
| Mortgage loans held for sale                   | 4,771              | 4,822        | 4,035              | 4,064        |
| Securities                                     | 165,607            | 165,606      | 148,843            | 148,854      |
| Federal Home Loan Bank stock                   | 3,931              | 3,931        | 3,591              | 3,591        |
| Loans, net                                     | 1,188,488          | 1,173,385    | 1,136,751          | 1,124,651    |
| Accrued interest receivable                    | 6,516              | 6,516        | 6,917              | 6,917        |
| <b>Financial liabilities</b>                   |                    |              |                    |              |
| Deposits                                       | \$ 1,106,707       | \$ 1,111,638 | \$ 1,103,242       | \$ 1,103,242 |
| Short-term borrowings                          | 119,364            | 119,364      | 85,047             | 85,047       |
| Long-term borrowings                           | 90,090             | 91,090       | 60,120             | 59,894       |
| Accrued interest payable                       | 1,092              | 1,092        | 829                | 829          |
| <b>Off balance sheet financial instruments</b> |                    |              |                    |              |
| Commitments to extend credit                   |                    |              |                    |              |
| Standby letters of credit                      |                    | (291)        |                    | (256)        |

Management used the following methods and assumptions to estimate the fair value of each class of financial instrument for which it is practicable to estimate the value.

**Cash, Short-term investments, Federal Home Loan Bank stock, Accrued interest receivable/payable and Short-term borrowings**

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

**Securities**

For securities, fair value equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities or dealer quotes.

### **Mortgage loans held for sale**

The fair value of mortgage loans held for sale is determined by market quotes for each loan based on loan type, term and size.

### **Loans, net**

The fair value of loans is estimated by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

### **Deposits**

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-rate certificates of deposits is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities. If the discounted future cash flows are less than the current value, Bancorp utilizes the current payable instead of the present value of contracted maturities at the current origination rate.

### **Long-term borrowings**

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

### **Commitments to extend credit and standby letters of credit**

The fair values of commitments to extend credit are estimated using fees currently charged to enter into similar agreements and the creditworthiness of the customers. The fair values of standby letters of credit are based on fees currently charged for similar agreements or the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date.

### **Limitations**

The fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market exists for a significant portion of Bancorp's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with

precision. Changes in assumptions could significantly affect the estimates.

**(19) Regulatory Matters**

Bancorp and the Bank are subject to various capital requirements prescribed by banking regulations and administered by federal banking agencies. Under these requirements, Bancorp and the Bank must meet minimum amounts and percentages of Tier I and total capital, as defined, to risk weighted assets and Tier I capital to average assets. Risk weighted assets are determined by applying certain risk weightings prescribed by the regulations to various categories of assets and off-balance sheet commitments. Capital and risk weighted assets may be further subject to qualitative judgments by regulators as to components, risk weighting and other factors. Failure to meet the capital requirements can result in certain mandatory, and possibly discretionary, corrective actions prescribed by the regulations or determined to be necessary by the regulators, which could materially affect the consolidated financial statements. Management believes Bancorp and the Bank met all capital requirements to which they were subject as of December 31, 2007.

As of December 2007 and 2006, the Bank's primary regulator categorized the Bank as well capitalized under the regulatory framework. There are no conditions or events since those notifications that management believes have changed the Bank's capital categories.

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A summary of Bancorp's and the Bank's capital ratios at December 31, 2007 and 2006 follows:

| December 31, 2007<br>(Dollars in thousands)         | Actual     |        | Minimum For<br>Adequate |       | Minimum For Well<br>Capitalized |        |
|---|------------|--------|-------------------------|-------|---------------------------------|--------|
|   | Amount     | Ratio  | Amount                  | Ratio | Amount                          | Ratio  |
| <b>Total risk-based capital (1)</b>                 |            |        |                         |       |                                 |        |
| Consolidated  | \$ 145,799 | 10.82% | \$ 107,774              | 8.00% | \$ 134,718                      | 10.00% |
| Bank  | 146,157    | 10.91% | 107,212                 | 8.00% | 134,015                         | 10.00% |
| <b>Tier I risk-based capital (1)</b>                |            |        |                         |       |                                 |        |
| Consolidated  | 132,259    | 9.82%  | 53,887                  | 4.00% | 80,831                          | 6.00%  |
| Bank  | 132,617    | 9.90%  | 46,785                  | 4.00% | 80,409                          | 6.00%  |
| <b>Leverage (2)</b>                                 |            |        |                         |       |                                 |        |
| Consolidated  | \$ 132,259 | 9.21%  | \$ 43,090               | 3.00% | \$ 71,816                       | 5.00%  |
| Bank  | 132,617    | 9.31%  | 41,255                  | 3.00% | 68,759                          | 5.00%  |
| <b>December 31, 2006<br/>(Dollars in thousands)</b> |            |        |                         |       |                                 |        |
|   | Actual     |        | Minimum For<br>Adequate |       | Minimum For Well<br>Capitalized |        |
|   | Amount     | Ratio  | Amount                  | Ratio | Amount                          | Ratio  |
| <b>Total risk-based capital (1)</b>                 |            |        |                         |       |                                 |        |
| Consolidated  | \$ 150,099 | 11.77% | \$ 102,002              | 8.00% | \$ 127,502                      | 10.00% |
| Bank  | 136,245    | 10.75% | 101,438                 | 8.00% | 126,797                         | 10.00% |
| <b>Tier I risk-based capital (1)</b>                |            |        |                         |       |                                 |        |
| Consolidated  | 137,776    | 10.81% | 51,001                  | 4.00% | 76,501                          | 6.00%  |
| Bank  | 123,922    | 9.77%  | 50,719                  | 4.00% | 76,078                          | 6.00%  |
| <b>Leverage (2)</b>                                 |            |        |                         |       |                                 |        |
| Consolidated  | \$ 137,776 | 10.18% | \$ 40,589               | 3.00% | \$ 67,648                       | 5.00%  |
| Bank  | 123,922    | 9.01%  | 41,255                  | 3.00% | 68,759                          | 5.00%  |

(1) Ratio is computed in relation to risk-weighted assets.

(2) Ratio is computed in relation to average assets.

**(20) S.Y. Bancorp, Inc. (parent company only)****Condensed Balance Sheets**

| (In thousands)   | December 31,      |                   |
|--|-------------------|-------------------|
|  | 2007              | 2006              |
| <b>Assets</b>  |                   |                   |
| Cash on deposit with subsidiary bank                                       | \$ 344            | \$ 6,439          |
| Investment in and receivable from subsidiaries                             | 133,811           | 125,872           |
| Securities available for sale (amortized cost of \$3,250 in 2007 and 2006) | 3,162             | 3,453             |
| Other assets   | 5,986             | 3,804             |
| <b>Total assets</b>  | <b>\$ 143,303</b> | <b>\$ 139,568</b> |
| <b>Liabilities and stockholders equity</b>                                 |                   |                   |
| Short-term borrowings  | \$ 8,900          | \$                |
| Other liabilities  | 1,379             | 2,124             |
| Stockholders equity  | 133,024           | 137,444           |
| <b>Total liabilities and stockholders equity</b>                           | <b>\$ 143,303</b> | <b>\$ 139,568</b> |

**Condensed Statements of Income**

| (In thousands)  | Years ended December 31, |                  |                  |
|---|--------------------------|------------------|------------------|
|   | 2007                     | 2006             | 2005             |
| Income dividends and interest from subsidiaries                                 | \$ 14,942                | \$ 33,405        | \$ 11,541        |
| Income interest income from securities  | 120                      | 111              | 101              |
| Income other  | 921                      |                  |                  |
| Expenses  | 934                      | 3,025            | 2,325            |
| Income before income taxes and equity in undistributed net income of subsidiary | 15,049                   | 30,491           | 9,317            |
| Income tax (benefit) expense  | (267)                    | 1,010            | 759              |
| Income before equity in undistributed net income of subsidiary                  | 15,316                   | 31,501           | 10,076           |
| Equity in undistributed net income of subsidiary                                | 8,736                    | (8,605)          | 11,568           |
| <b>Net income</b>   | <b>\$ 24,052</b>         | <b>\$ 22,896</b> | <b>\$ 21,644</b> |

## Condensed Statements of Cash Flows

| (In thousands)  | Years ended December 31, |                 |                 |
|---|--------------------------|-----------------|-----------------|
|   | 2007                     | 2006            | 2005            |
| <b>Operating activities</b>   |                          |                 |                 |
| Net income  | \$ 24,052                | \$ 22,896       | \$ 21,644       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |                 |                 |
| Equity in undistributed net income of subsidiaries                                | (8,736)                  | 8,605           | (11,568)        |
| Decrease in receivable from subsidiaries  | 2,082                    | 5,329           | 1,281           |
| Non-cash compensation expense from vesting of stock options, net of tax           |                          |                 | 34              |
| Stock compensation expense  | 467                      | 531             |                 |
| Income tax benefit of stock options exercised                                     |                          |                 | 260             |
| Excess tax benefit from share-based compensation arrangements                     | (53)                     | (83)            |                 |
| (Increase) decrease in other assets   | (2,080)                  | 849             | 560             |
| (Decrease) Increase in other liabilities  | (734)                    | 213             | (738)           |
| <b>Net cash provided by operating activities</b>                                  | <b>14,998</b>            | <b>38,340</b>   | <b>11,473</b>   |
| <b>Investing activities</b>   |                          |                 |                 |
| Purchases of securities available for sale  |                          | (2,000)         |                 |
| <b>Net cash used in investing activities</b>                                      |                          | <b>(2,000)</b>  |                 |
| <b>Financing activities</b>   |                          |                 |                 |
| Net increase in short-term borrowings   | 8,900                    |                 |                 |
| Repayments of subordinated debentures   |                          | (20,619)        |                 |
| Proceeds from stock options   | 1,193                    | 1,539           | 851             |
| Excess tax benefit from share-based compensation agreements                       | 53                       | 83              |                 |
| Common stock repurchases  | (22,369)                 | (5,271)         | (5,496)         |
| Cash dividends paid   | (8,870)                  | (7,945)         | (6,786)         |
| <b>Net cash used in financing activities</b>                                      | <b>(21,093)</b>          | <b>(32,213)</b> | <b>(11,431)</b> |
| <b>Net increase (decrease) in cash</b>  | <b>(6,095)</b>           | <b>4,127</b>    | <b>42</b>       |
| <b>Cash at beginning of year</b>  | <b>6,439</b>             | <b>2,312</b>    | <b>2,270</b>    |
| <b>Cash at end of year</b>  | <b>\$ 344</b>            | <b>\$ 6,439</b> | <b>\$ 2,312</b> |

**(21) Segments**

The Bank's, and thus Bancorp's principal activities include commercial banking and investment management and trust. Commercial banking provides a full range of loans and deposit products to individual consumers and businesses. Investment management and trust provides wealth management services, estate planning and administration, retirement plan management and custodian or trustee services.

The financial information for each business segment reflects that which is specifically identifiable or allocated based on an internal allocation method. Income taxes are allocated based on the effective federal income tax rate adjusted for any tax exempt activity. All tax exempt activity and provision for loan losses have been allocated to the commercial banking segment. The measurement of the performance of the business segments is based on the management structure of the Bank and is not necessarily comparable with similar information for any other financial institution. The information presented is also not necessarily indicative of the segments' operations if they were independent entities.

Principally, all of the net assets of S.Y. Bancorp, Inc. are involved in the commercial banking segment. Bancorp has goodwill of \$682,000 related to the purchase of a bank in southern Indiana in 1996. This purchase facilitated Bancorp's expansion in southern Indiana. Goodwill has been assigned to the commercial banking segment.

Selected financial information by business segment follows:

| (In thousands)                         | Years ended December 31, |                  |                  |
|--|--------------------------|------------------|------------------|
|  | 2007                     | 2006             | 2005             |
| <b>Net interest income</b>             |                          |                  |                  |
| Commercial banking                     | \$ 53,571                | \$ 53,734        | \$ 49,103        |
| Investment management and trust        | 206                      | 152              | 132              |
| <b>Total net interest income</b>       | <b>\$ 53,777</b>         | <b>\$ 53,886</b> | <b>\$ 49,235</b> |
| <b>Provision for loan losses</b>       |                          |                  |                  |
| Commercial banking                     | \$ 3,525                 | \$ 2,100         | \$ 225           |
| Investment management and trust        |                          |                  |                  |
| <b>Total provision for loan losses</b> | <b>\$ 3,525</b>          | <b>\$ 2,100</b>  | <b>\$ 225</b>    |
| <b>Non-interest income</b>             |                          |                  |                  |
| Commercial banking                     | \$ 17,360                | \$ 17,050        | \$ 16,549        |
| Investment management and trust        | 12,886                   | 11,632           | 10,813           |
| <b>Total non-interest income</b>       | <b>\$ 30,246</b>         | <b>\$ 28,682</b> | <b>\$ 27,362</b> |
| <b>Non-interest expenses</b>           |                          |                  |                  |
| Commercial banking                     | \$ 40,163                | \$ 40,660        | \$ 38,711        |
| Investment management and trust        | 6,368                    | 5,950            | 5,961            |
| <b>Total non-interest expenses</b>     | <b>\$ 46,531</b>         | <b>\$ 46,610</b> | <b>\$ 44,672</b> |
| <b>Income Taxes</b>                    |                          |                  |                  |



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|                                 |           |               |           |               |           |               |
|---------------------------------|-----------|---------------|-----------|---------------|-----------|---------------|
| Commercial banking              | \$        | 7,562         | \$        | 8,920         | \$        | 8,312         |
| Investment management and trust |           | 2,353         |           | 2,042         |           | 1,744         |
| <b>Total income taxes</b>       | <b>\$</b> | <b>9,915</b>  | <b>\$</b> | <b>10,962</b> | <b>\$</b> | <b>10,056</b> |
| <b>Net income</b>               |           |               |           |               |           |               |
| Commercial banking              | \$        | 19,681        | \$        | 19,104        | \$        | 18,404        |
| Investment management and trust |           | 4,371         |           | 3,792         |           | 3,240         |
| <b>Total net income</b>         | <b>\$</b> | <b>24,052</b> | <b>\$</b> | <b>22,896</b> | <b>\$</b> | <b>21,644</b> |

**(22) Quarterly Operating Results (unaudited)**

Following is a summary of quarterly operating results (unaudited) for 2007 and 2006:

| (In thousands, except per share data) | 2007      |           |           |           | 2006      |           |           |           |
|---------------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
|                                       | 4th Qtr.  | 3rd Qtr.  | 2nd Qtr.  | 1st Qtr.  | 4th Qtr.  | 3rd Qtr.  | 2nd Qtr.  | 1st Qtr.  |
| Interest income                       | \$ 22,833 | \$ 23,062 | \$ 22,815 | \$ 22,606 | \$ 22,727 | \$ 22,029 | \$ 21,244 | \$ 20,327 |
| Interest expense                      | 9,590     | 9,521     | 9,236     | 9,192     | 8,871     | 8,422     | 7,794     | 7,354     |
| Net interest income                   | 13,243    | 13,541    | 13,579    | 13,414    | 13,856    | 13,607    | 13,450    | 12,973    |
| Provision for loan losses             | 1,435     | 850       | 460       | 780       | 700       | 450       | 600       | 350       |
| Net interest income after provision   | 11,808    | 12,691    | 13,119    | 12,634    | 13,156    | 13,157    | 12,850    | 12,623    |
| Non-interest income                   | 7,800     | 7,566     | 7,724     | 7,156     | 7,531     | 7,009     | 7,229     | 6,913     |
| Non-interest expenses                 | 12,146    | 11,527    | 11,484    | 11,374    | 11,641    | 11,913    | 11,278    | 11,778    |
| Income before income taxes            | 7,462     | 8,730     | 9,359     | 8,416     | 9,046     | 8,253     | 8,801     | 7,758     |
| Income tax expense                    | 1,298     | 2,843     | 3,062     | 2,712     | 2,759     | 2,832     | 2,933     | 2,438     |
| Net income                            | \$ 6,164  | \$ 5,887  | \$ 6,297  | \$ 5,704  | \$ 6,287  | \$ 5,421  | \$ 5,868  | \$ 5,320  |
| Basic earnings per share              | \$ 0.45   | \$ 0.42   | \$ 0.44   | \$ 0.40   | \$ 0.44   | \$ 0.38   | \$ 0.41   | \$ 0.37   |
| Diluted earnings per share            | 0.44      | 0.41      | 0.43      | 0.39      | 0.43      | 0.37      | 0.40      | 0.36      |

Note: The sum of basic and diluted earnings per share of each of the quarters in 2007 and 2006 may not add to the year to date amount reported in Bancorp's consolidated financial statements due to rounding.

**Report of Independent Registered Public Accounting Firm**

**To the Board of Directors and Stockholders  
S.Y. Bancorp, Inc.:**

We have audited the accompanying consolidated balance sheets of S.Y. Bancorp, Inc. and subsidiary (the Company) as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in stockholders' equity, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of S.Y. Bancorp, Inc. and subsidiary as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), S.Y. Bancorp, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 13, 2008 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Louisville, Kentucky

March 13, 2008



## Management's Report on Consolidated Financial Statements

The accompanying consolidated financial statements and other financial data were prepared by the management of S.Y. Bancorp, Inc. (Bancorp), which has the responsibility for the integrity of the information presented. The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and, as such, include amounts that are the best estimates and judgments of management with consideration given to materiality.

Management is further responsible for maintaining a system of internal controls designed to provide reasonable assurance that the books and records reflect the transactions of Bancorp and that its established policies and procedures are carefully followed. Management believes that Bancorp's system, taken as a whole, provides reasonable assurance that transactions are executed in accordance with management's general or specific authorization; transactions are recorded as necessary to permit preparation of financial statements in conformity with U.S. generally accepted accounting principles and to maintain accountability for assets; access to assets is permitted only in accordance with management's general or specific authorization, and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Management also seeks to assure the objectivity and integrity of Bancorp's financial data by the careful selection and training of qualified personnel, an internal audit function and organizational arrangements that provide an appropriate division of responsibility.

Bancorp's independent auditors, KPMG LLP, have audited the consolidated financial statements. Their audit was conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) which provides for consideration of Bancorp's internal controls to the extent necessary to determine the nature, timing, and extent of their audit tests.

The Board of Directors pursues its oversight role for the consolidated financial statements through the Audit Committee. The Audit Committee meets periodically and privately with management, the internal auditors, and the independent auditors to review matters relating to financial reporting, the internal control systems, and the scope and results of audit efforts. The internal and independent auditors have unrestricted access to the Audit Committee, with and without the presence of management, to discuss accounting, auditing, and financial reporting matters. The Audit Committee also recommends the appointment of the independent auditors to Board of Directors, and ultimately has sole authority to appoint or replace the independent auditors.

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

/s/ Nancy B. Davis  
Nancy B. Davis  
Executive Vice President  
and Chief Financial Officer

**Item 9.** Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

**Item 9A.** Controls and Procedures

Bancorp maintains disclosure controls and procedures designed to ensure that it is able to collect the information it is required to disclose in the reports it files with the Securities and Exchange Commission (SEC), and to process, summarize and disclose this information within the time periods specified in the rules of the SEC. Based on their evaluation of Bancorp's disclosure controls and procedures which took place as of December 31, 2007, the Chief Executive and Chief Financial Officers believe that these controls and procedures are effective to ensure that Bancorp is able to collect, process and disclose the information it is required to disclose in the reports it files with the SEC within the required time periods.

Based on the evaluation of Bancorp's disclosure controls and procedures by the Chief Executive and Chief Financial Officers, no changes occurred during the fiscal quarter ended December 31, 2007 in Bancorp's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, Bancorp's internal control over financial reporting.

### Management's Report on Internal Control Over Financial Reporting

The management of S.Y. Bancorp, Inc and subsidiary (Bancorp) is responsible for establishing and maintaining adequate internal control over financial reporting. Bancorp's internal control over financial reporting is a process designed under the supervision of Bancorp's Chief Executive Officer and Chief Financial Officer, and effected by Bancorp's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. This process includes those policies and procedures that:

1. Pertain to the maintenance of records, that in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Bancorp;
2. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of Bancorp are being made only in accordance with authorizations of management and directors of Bancorp; and
3. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of Bancorp's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Management has assessed the effectiveness of its internal control over financial reporting as of December 31, 2007, based on the control criteria established in a report entitled *Internal Control - Integrated Framework*, issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on such assessment, management has concluded that Bancorp's internal control over financial reporting is effective as of December 31, 2007.

KPMG LLP, the independent registered public accounting firm that audited the consolidated financial statements of Bancorp included in this Annual Report on Form 10-K, has also audited the effectiveness of Bancorp's internal control over financial reporting as of December 31, 2007. The report expresses an unqualified opinion on the effectiveness of Bancorp's internal control over financial reporting as of December 31, 2007.

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

/s/ Nancy B. Davis

Nancy B. Davis  
Executive Vice President  
and Chief Financial Officer



**Report of Independent Registered Public Accounting Firm**

**To the Board of Directors and Stockholders  
S.Y. Bancorp, Inc.:**

We have audited S.Y. Bancorp, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). S.Y. Bancorp, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on S.Y. Bancorp, Inc.'s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, S.Y. Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of S.Y. Bancorp, Inc. and subsidiary as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in stockholders' equity, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2007, and our report dated March 13, 2008 expressed an unqualified opinion on those consolidated financial statements.

Louisville, Kentucky

March 13, 2008

**Item 9B. Other Information**

None

**Part III**

**Item 10. Directors, Executive Officers and Corporate Governance**

Information regarding the directors and executive officers of Bancorp is incorporated herein by reference to the discussion under the heading, ITEM 3. ELECTION OF ELEVEN DIRECTORS, and SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE in Bancorp's Proxy Statement for the 2008 Annual Meeting of Shareholders and the section captioned EXECUTIVE OFFICERS OF THE REGISTRANT in this Form 10-K.

Information regarding the Audit Committee is incorporated herein by reference to the discussion under the heading, CORPORATE GOVERNANCE AND RELATED MATTERS BOARD OF DIRECTORS MEETINGS AND COMMITTEES in Bancorp's Proxy Statement for the 2008 Annual Meeting of Shareholders.

Information regarding principal occupation of directors of Bancorp follows:

David H. Brooks Retired. Former Chairman and Chief Executive Officer, S.Y. Bancorp, Inc. and Stock Yards Bank & Trust Company;

James E. Carrico Senior Vice President, Wells Fargo Insurance Services of Kentucky, Inc.;

Charles R. Edinger, III President, J. Edinger & Son, Inc.;

David P. Heintzman Chairman, President and Chief Executive Officer, S.Y. Bancorp, Inc. and Stock Yards Bank & Trust Company;

Carl G. Herde Vice President of Finance and Chief Financial Officer, Baptist Healthcare System, Inc.;

Richard A. Lechleiter Executive Vice President and Chief Financial Officer, Kindred Healthcare, Inc.;

Bruce P. Madison President and Chief Executive Officer, Plumbers Supply Company, Inc.;

Nicholas X. Simon President and Chief Executive Officer, Publishers Printing Company, LLC;

Norman Tasman President, Tasman Industries Inc. and Tasman Hide Processing Inc.;

Robert L. Taylor Professor of Management and Dean Emeritus, College of Business, University of Louisville;

Kathy C. Thompson Senior Executive Vice President, S.Y. Bancorp, Inc. and Stock Yards Bank & Trust Company.

The Board of Directors of Bancorp has adopted a code of ethics for its chief executive officer and financial executives. A copy of the code of ethics is filed as an exhibit to this Annual Report.

**Item 11. Executive Compensation**

Information regarding the compensation of Bancorp's executive officers and directors is incorporated herein by reference to the discussion under the heading, EXECUTIVE COMPENSATION AND OTHER INFORMATION REPORT ON EXECUTIVE COMPENSATION in Bancorp's Proxy Statement for the 2008 Annual Meeting of Shareholders.

Information regarding the Compensation Committee is incorporated herein by reference to the discussion under the heading, TRANSACTIONS WITH MANAGEMENT AND OTHERS in Bancorp's Proxy Statement for the 2008 Annual Meeting of Shareholders. The report of the Compensation Committee 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.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this item is incorporated herein by reference to the discussion under the headings, ITEM 3. ELECTION OF ELEVEN DIRECTORS and SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT, in Bancorp's Proxy Statement for the 2008 Annual Meeting of Shareholders.

**Equity Compensation Plan Information**

The following table furnishes common shares authorized for issuance under equity compensation plans. Bancorp has currently issued stock options and restricted stock as equity compensation. The 1995 Stock Incentive Plan does include stock appreciation rights; however, it does not contain provisions for stock warrants. The 2005 Stock Incentive Plan includes provisions for options, restricted stock and stock appreciation rights. For further information on stock options see note 15 to the consolidated financial statements in this Form 10-K.

| Plan Category  | Number of securities to be issued upon exercise of outstanding options | Weighted-average exercise price of outstanding options | Number of securities to be issued upon vesting of restricted shares | Number of securities remaining available for future issuance under equity compensation plans |
|--|--|--|---|--|
| Equity compensation plans approved by shareholders     | 1,015,698  | \$ 19.65   | 4,275   | 401,090  |
| Equity compensation plans not approved by shareholders |  |  |   |  |

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by this item is incorporated herein by reference to the discussion under the headings, ITEM 3. ELECTION OF ELEVEN DIRECTORS and TRANSACTIONS WITH MANAGEMENT AND OTHERS, in Bancorp's Proxy Statement for the 2008 Annual Meeting of Shareholders.

**Item 14. Principal Accountant Fees and Services**

The information required by this item is incorporated herein by reference to the discussion under the heading, REPORT OF THE AUDIT COMMITTEE in Bancorp's Proxy Statement for the 2008 Annual Meeting of Shareholders.



**Part IV**

**Item 15. Exhibits and Financial Statement Schedules**

(a) 1. The following financial statements are included in this Form 10-K:

Consolidated Balance Sheets - December 31, 2007 and 2006

Consolidated Statements of Income - years ended December 31, 2007, 2006 and 2005

Consolidated Statements of Changes in Stockholders' Equity - years ended December 31, 2007, 2006 and 2005

Consolidated Statements of Comprehensive Income - years ended December 31, 2007, 2006 and 2005

Consolidated Statements of Cash Flows - years ended December 31, 2007, 2006 and 2005

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

(a) 2. List of Financial Statement Schedules

Schedules to the consolidated financial statements of Bancorp are omitted since they are either not required under the related instructions, are inapplicable, or the required information is shown in the consolidated financial statements or notes thereto.

(a) 3. List of Exhibits

- 3.1 Articles of Incorporation of Bancorp filed with the Secretary of State of Kentucky on January 12, 1988. Exhibit 3.1 to Annual Report on Form 10-K for the year ended December 31, 2001, of Bancorp is incorporated by reference herein.
- 3.2 Articles of Amendment to the Articles of Incorporation of Bancorp filed with the Secretary of State of Kentucky on May 8, 1989. Exhibit 3.2 to Annual Report on Form 10-K for the year ended December 31, 2001, of Bancorp is incorporated by reference herein.
- 3.3 Articles of Amendment to the Articles of Incorporation of Bancorp filed with the Secretary of State of Kentucky on June 30, 1994. Exhibit 3.3 to Annual Report on Form 10-K for the year ended December 31, 2001, of Bancorp is incorporated by reference herein.
- 3.4 Articles of Amendment to the Articles of Incorporation of Bancorp filed with the Secretary of State of Kentucky on May 14, 1996.
- 3.5 Articles of Amendment to the Articles of Incorporation of Bancorp filed with the Secretary of State of Kentucky on April 29, 1998. Exhibit 3.5 to Annual Report on Form 10-K for the year ended December 31, 2001, of Bancorp is incorporated by reference herein.
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- 10.2\* The Stock Yards Bank & Trust Company Executive Nonqualified Deferred Compensation Plan (as Amended and Restated in 2006), as filed as Exhibit 10.2 to Form 8-K filed on October 23, 2006, is incorporated by reference herein.
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- 10.12\* Terms of Restricted Stock Program, as filed as Exhibit 10.1 to Form 8-K filed on February 26, 2007, is incorporated by reference herein.
- 10.13\* Form of Restricted Stock Agreement, as filed as Exhibit 10.2 to Form 8-K filed on February 26, 2007, is incorporated by reference herein.
- 10.14\* Form of Stock Option Grant and Agreement (6 months vesting), as filed as Exhibit 10.1 to Form 8-K filed on January 19, 2006, is incorporated by reference herein.
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- 32.1 Certifications pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by David P. Heintzman.
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\* Indicates matters related to executive compensation.

Copies of the foregoing Exhibits will be furnished to others upon request and payment of Bancorp's reasonable expenses in furnishing the exhibits.

### (b) Exhibits

The exhibits listed in response to Item 15(a) 3 are filed or furnished as a part of this report.

### (c) Financial Statement Schedules

None



**Where You Can Find More Information**

Bancorp is subject to the informational requirements of the Securities Exchange Act of 1934 and accordingly files its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and other information with the Securities and Exchange Commission ( SEC ). The public may read and copy any materials filed with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Please call the SEC at (800) SEC-0330 for further information on the Public Reference Room. Bancorp's public filings are also maintained on the SEC's Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. The address of that web site is <http://www.sec.gov>. In addition, 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 may be accessed free of charge through Bancorp's web site after we have electronically filed such material with, or furnished it to, the SEC. The address of that web site is <http://www.syb.com>.

**Signatures**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

March 13, 2008

S.Y. BANCORP, INC.

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

|  |   |                |
|--|---|----------------|
| /s/ David P. Heintzman<br>David P. Heintzman           | Chairman, President, Chief Executive Officer<br>and Director (principal executive officer)              | March 13, 2008 |
| /s/ Nancy B. Davis<br>Nancy B. Davis                   | Executive Vice President and Chief Financial<br>Officer (principal financial and accounting<br>officer) | March 13, 2008 |
| /s/ David H. Brooks<br>David H. Brooks                 | Director  | March 13, 2008 |
| /s/ James E. Carrico<br>James E. Carrico               | Director  | March 13, 2008 |
| /s/ Charles R. Edinger, III<br>Charles R. Edinger, III | Director  | March 13, 2008 |
| /s/ Carl G. Herde<br>Carl G. Herde                     | Director  | March 13, 2008 |
| /s/ Richard A. Lechleiter<br>Richard A. Lechleiter     | Director  | March 13, 2008 |
| /s/ Bruce P. Madison<br>Bruce P. Madison               | Director  | March 13, 2008 |
| /s/ Nicholas X. Simon<br>Nicholas X. Simon             | Director  | March 13, 2008 |
| /s/ Norman Tasman<br>Norman Tasman                     | Director  | March 13, 2008 |
| s/ Robert L. Taylor<br>Robert L. Taylor                | Director  | March 13, 2008 |
| /s/ Kathy C. Thompson                                  | Senior Executive Vice President and Director  | March 13, 2008 |

Kathy C. Thompson

**Index to Exhibits**

Exhibit Number

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