

S&T BANCORP INC
Form 10-K
February 28, 2007
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2006

Commission file number 1-12508

S&T BANCORP, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of incorporation of organization)

800 Philadelphia Street, Indiana, PA
(Address of principal executive offices)

25-1434426
(I.R.S. Employer Identification No.)

15701
(Zip Code)

Registrant's telephone number, including area code (800) 325-2265

Securities registered pursuant to Section 12(b) of the Act: **None**

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

Common Stock, Par Value \$2.50 per share

Edgar Filing: S&T BANCORP INC - Form 10-K

(Title of class)

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 (229.405 of this chapter) is not contained herein, and will not be contained, to the best of 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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes No

The aggregate market value of the voting and non-voting common equity held by nonaffiliates of the registrant as of June 30, 2006:

Common Stock, \$2.50 par value \$807,686,187

The number of shares outstanding of the issuer's classes of common stock as of February 12, 2007:

Common Stock, \$2.50 par value 25,314,324 shares

DOCUMENTS INCORPORATED BY REFERENCE

Edgar Filing: S&T BANCORP INC - Form 10-K

Portions of the proxy statement for the annual shareholders meeting to be held April 16, 2007 are incorporated by reference into Part III.

Table of Contents

Part I

| | | |
|----------|--|----|
| Item 1. | <u>Business</u> | 3 |
| Item 1A. | <u>Risk Factors</u> | 9 |
| Item 1B. | <u>Unresolved Staff Comments</u> | 10 |
| Item 2. | <u>Properties</u> | 11 |
| Item 3. | <u>Legal Proceedings</u> | 12 |
| Item 4. | <u>Submission of Matters to a Vote of Security Holders</u> | 12 |

Part II

| | | |
|----------|---|----|
| Item 5. | <u>Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Repurchases of Equity Securities</u> | 13 |
| Item 6. | <u>Selected Financial Data</u> | 15 |
| Item 7. | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 16 |
| Item 7A. | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 40 |
| Item 8. | <u>Financial Statements and Supplementary Data</u> | 44 |
| Item 9. | <u>Changes and Disagreements with Accountants on Accounting and Financial Disclosures</u> | 79 |
| Item 9A. | <u>Controls and Procedures</u> | 79 |
| Item 9B. | <u>Other Information</u> | 79 |

Part III

| | | |
|----------|---|----|
| Item 10. | <u>Directors, Executive Officers and Corporate Governance</u> | 80 |
| Item 11. | <u>Executive Compensation</u> | 80 |
| Item 12. | <u>Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u> | 80 |
| Item 13. | <u>Certain Relationships and Related Transactions, and Director Independence</u> | 80 |
| Item 14. | <u>Principal Accounting Fees and Services</u> | 80 |

Part IV

| | | |
|----------|--|----|
| Item 15. | <u>Exhibits, Financial Statement Schedules</u> | 81 |
| | <u>Signatures</u> | 83 |

Table of Contents

Part I

Item 1. Business

General

S&T Bancorp, Inc. (S&T ; references to we or us refers to S&T, including on a consolidated basis with our subsidiaries where appropriate) was incorporated on March 17, 1983 under the laws of the Commonwealth of Pennsylvania as a bank holding company and has two wholly owned subsidiaries, S&T Bank and 9th Street Holdings, Inc. S&T owns a one-half interest in Commonwealth Trust Credit Life Insurance Company (CTCLIC). S&T is registered as a financial holding company with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956, as amended (BHCA).

As of December 31, 2006, S&T had approximately \$3.3 billion in total assets, \$339.1 million in total shareholder s equity and \$2.6 billion in total deposits. S&T Bank deposits are insured by the Federal Deposit Insurance Corporation (FDIC) to the maximum extent provided by law.

S&T Bank is a full service bank with its Main Office at 800 Philadelphia Street, Indiana, Pennsylvania, providing service to its customers through a branch network of 49 offices located in Allegheny, Armstrong, Blair, Butler, Cambria, Clarion, Clearfield, Indiana, Jefferson and Westmoreland counties of Pennsylvania.

S&T Bank s services include accepting time and demand deposit accounts, originating commercial and consumer loans, providing letters of credit, offering discount brokerage services, personal financial planning, credit card services and insurance products. Management believes that S&T Bank has a relatively stable deposit base and no material amount of deposits are obtained from a single depositor or group of depositors (including federal, state and local governments). S&T Bank has not experienced significant fluctuations in deposits.

Total wealth management assets under management were approximately \$1.4 billion at December 31, 2006. Wealth management services include services as executor and trustee under wills and deeds, as guardian and custodian of employee benefits and other trusts and brokerage services.

S&T Bank has four wholly owned subsidiaries, S&T Insurance Group, LLC, S&T Banc Holdings, Inc., S&T Professional Resources Group, LLC and Stewart Capital Advisors, LLC. In May 2002, S&T Professional Resources Group, LLC was formed to market software developed by S&T. In August 2002, S&T Banc Holdings, Inc. was formed as an investment holding company. In August 2002, S&T Bank acquired Evergreen Insurance Associates, Inc., a multi-line insurance agency with a client base of approximately 2,000 customers in Pennsylvania, Maryland and West Virginia. Evergreen Insurance Associates, Inc. was merged into Evergreen Acquisition, LLC, with a resulting name change to Evergreen Insurance Associates, LLC (Evergreen), a wholly owned subsidiary of S&T Insurance Group, LLC. Evergreen provides insurance programs structured to the individual needs of its customers, and offers a full line of commercial property and casualty insurance, group life and health coverage, employee benefit solutions as well as personal insurance. Stewart Capital Advisors, LLC, formed in August 2005, is a registered investment advisor that manages private investment accounts for individuals and institutions and advises the Stewart Capital Mutual Funds.

Employees

As of December 31, 2006, S&T Bank and subsidiaries had 790 full-time equivalent employees. S&T provides a variety of employment benefits and considers its relationship with its employees to be good.

Access to United States Securities and Exchange Commission Filings

All reports filed electronically by S&T with the United States Securities and Exchange Commission (SEC), including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and our annual proxy statements, as well as any amendments to those reports, are

PAGE 3

Table of Contents

Item 1. BUSINESS continued

accessible at no cost on our website at www.stbancorp.com. These filings are also accessible on the SEC's website at www.sec.gov. You may also read and copy any material S&T files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

Supervision and Regulation

General

S&T and S&T Bank are each extensively regulated under federal and state law. The following describes certain aspects of such regulation and does not purport to be a complete description of all regulations that affect S&T or all aspects of such regulations.

To the extent statutory or regulatory provisions are described, the description is qualified in its entirety by reference to the particular statutory or regulatory provisions. Proposals to change the laws and regulations governing the banking industry are frequently raised in Congress, in state legislatures and before the various bank regulatory agencies. The likelihood and timing on any changes and the impact such changes might have on S&T or S&T Bank are impossible to determine with any certainty.

Any change in applicable laws or regulations, or in the way such laws or regulations are interpreted by regulatory agencies or courts, may have a material impact on our business, operations and earnings.

S&T

S&T is a bank holding company subject to regulation under the BHCA, and the examination and reporting requirements of the Federal Reserve System (the Federal Reserve Board). Under the BHCA, a bank holding company may not directly or indirectly acquire ownership or control of more than five (5) percent of the voting shares or substantially all of the assets of any additional bank, or merge or consolidate with another bank holding company, without the prior approval of the Federal Reserve Board. S&T has received such approvals from the Federal Reserve Board for the following passive ownership positions:

| Name of Entity | % Approved | % of Outstanding Shares Owned by S&T |
|--------------------------------|-------------------|---|
| Allegheny Valley Bancorp, Inc. | 24.9% | 14.0% |
| CBT Financial Corp. | 9.9% | 5.4% |
| IBT Bancorp, Inc. | 9.9% | 8.0% |

S&T also is subject to the supervision and regulation of the Pennsylvania Department of Banking (PADB). S&T elected to become a financial holding company under the BHCA in 2001 and thereby engage in a broader range of financial and other activities than are permissible for traditional bank holding companies. In order to qualify and maintain its status as a financial holding company, the depository institutions controlled by S&T must remain well capitalized and well managed (as defined in federal law), and have at least a satisfactory Community Reinvestment Act (CRA) rating. S&T and S&T Bank currently satisfy these criteria. No regulatory approval is required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to

Edgar Filing: S&T BANCORP INC - Form 10-K

activities that are financial in nature, as determined by the Federal Reserve Board. The BHCA identifies several activities as financial in nature including, among others, securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and sales agency; investment advisory activities; merchant banking activities; and activities that the Federal Reserve Board has

PAGE 4

Table of Contents

Item 1. BUSINESS continued

determined to be closely related to banking or a proper incident thereto. Banks also may engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting, insurance company portfolio investment, real estate development and real estate investment, through a financial subsidiary of the bank, if the bank is well capitalized, well managed and has at least a satisfactory CRA rating.

If S&T Bank ceases to be well capitalized or well managed, S&T will not be in compliance with the requirements of the BHCA regarding financial holding companies. If a financial holding company is notified by the Federal Reserve Board of such a change in the ratings of any of its subsidiary banks, it must take certain corrective actions within specified time frames. Furthermore, if S&T Bank were to receive a CRA rating under the Community Reinvestment Act of less than satisfactory, then S&T would be prohibited from engaging in new activities or acquiring companies other than bank holding companies, banks or savings associations until the rating is raised to satisfactory or better.

S&T is presently engaged in nonbanking activities through the following six entities: 9th Street Holdings, Inc., S&T Bancholdings, Inc., CTCLIC, S&T Insurance Group, LLC, S&T Professional Resources Group, LLC and Stewart Capital Advisors, LLC. 9th Street Holdings, Inc. was formed in June 1988 and S&T Bancholdings, Inc. was formed in August 2002 to hold and manage a group of investments previously owned by S&T Bank and to give S&T additional latitude to purchase other investments. CTCLIC, which is a joint venture with another financial institution, acts as a reinsurer of credit life, accident and health insurance policies sold by S&T Bank and the other institution. S&T Insurance Group, LLC distributes high-quality life insurance and long-term disability income insurance products. During 2002, S&T Insurance Group, LLC expanded into the property and casualty insurance business with the acquisition of Evergreen Insurance Associates, LLC. S&T Professional Resources Group, LLC markets software developed by S&T. Stewart Capital Advisors, LLC, formed in August 2005, is a registered investment advisor that manages private investment accounts for individuals and institutions and advises the Stewart Capital Mutual Funds.

S&T Bank

As a state-chartered, commercial bank, the deposits of which are insured by the FDIC, S&T Bank is subject to the supervision and regulation of the PADB and the FDIC. S&T Bank also is subject to various requirements and restrictions under federal and state law, including requirements to maintain reserves against deposits, restrictions on the types, amount and terms and conditions of loans that may be granted, and limits on the type of other activities in which S&T Bank may engage and the investments it may make.

S&T Bank also is subject to federal laws that limit the amount of transactions between itself and S&T or S&T's nonbank subsidiaries. Under these provisions, transactions by a bank with its parent company or any nonbank affiliate generally are limited to 10 percent of the bank subsidiary's capital and surplus or 20 percent in the aggregate. Further, loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also imposes similar restrictions on transactions between a bank and its financial subsidiaries. A bank, such as S&T Bank, is prohibited from purchasing any low quality asset from an affiliate. S&T Bank is in compliance with these provisions.

Insurance of Accounts; Depositor Preference

The deposits of S&T Bank are insured up to applicable limits per insured depositor by the FDIC. As an FDIC-insured bank, S&T Bank also is subject to FDIC insurance assessments. As a result of the Federal Deposit Insurance Reform Act of 2005, the FDIC adopted a revised risk-based assessment system to determine assessment rates to be paid by member institutions such as S&T Bank. Under this revised assessment system, risk is defined and measured using an institution's supervisory ratings with certain other risk measures, including certain financial ratios. The annual rates for 2007 for

Table of Contents

Item 1. BUSINESS continued

institutions in risk category I range from 5 to 7 basis points, [the rate for institutions in risk category II is 10 basis points and the rate for institutions in risk category III is 28 basis points]. These rates may be offset by a one time assessment credit held by an institution, based on the assessment base of that institution as of December 31, 1996, and in the future by dividends that may be declared by the FDIC if the deposit reserve ratio increases above a certain amount. The FDIC may raise or lower these assessment rates based on various factors to achieve a reserve ratio, which the FDIC currently has set at 1.25 percent of insured deposits.

In addition to deposit insurance fund assessments, the FDIC assesses all insured deposits a special assessment to fund the repayment of debt obligations of the Financing Corporation (FICO). FICO is a government-sponsored entity that was formed to borrow the money necessary to carry out the closing and ultimate disposition of failed thrift institutions by the Resolution Trust Corporation. At December 31, 2006, the annualized rate established by the FDIC for the FICO assessment was 1.24 basis points per \$100 of insured deposits.

Under federal law, deposits and certain claims for administrative expenses and employee compensation against insured depository institutions are afforded a priority over other general unsecured claims against such an institution, including federal funds and letters of credit, in the liquidation or other resolution of such an institution by any receiver appointed by regulatory authorities. Such priority creditors would include the FDIC.

Capital

The Federal Reserve Board and the FDIC have issued substantially similar risk-based and leverage capital guidelines applicable to banking organizations they supervise. Under the risk-based capital requirements, both S&T and S&T Bank generally are required to maintain a minimum ratio of total capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) of 8.00 percent. At least half of the total capital must be composed of common equity, retained earnings and qualifying perpetual preferred stock, less certain intangibles (Tier 1 capital). The remainder may consist of certain subordinated debt, certain hybrid capital instruments and other qualifying preferred stock, and a limited amount of the loan loss allowance (Tier 2 capital and, together with Tier 1 capital, Total capital). At December 31, 2006, S&T s Tier 1 and Total capital ratios were 9.68 percent and 11.93 percent, respectively, and the ratios of Tier 1 capital and Total capital to total risk-adjusted assets for S&T Bank were 8.54 percent and 10.64 percent, respectively.

In addition, each of the federal bank regulatory agencies has established minimum leverage capital ratio requirements for banking organizations. These requirements provide for a minimum leverage ratio of Tier 1 capital to adjusted average quarterly assets equal to 3.00 percent for bank and bank holding companies that meet certain specified criteria, including that they have the highest regulatory rating and are not experiencing significant growth or expansion. All other banks and bank holding companies generally are required to maintain a leverage ratio of at least 100 to 200 basis points above the stated minimum. At December 31, 2006, S&T s leverage ratio was 8.84 percent, and S&T Bank s leverage ratio was 7.74 percent.

Both the Federal Reserve Board and the FDIC s risk-based capital standards explicitly identify concentrations of credit risk and the risk arising from non-traditional activities, as well as an institution s ability to manage these risks, as important factors to be taken into account by the agency in assessing an institution s overall capital adequacy. The capital guidelines also provide that an institution s exposure to a decline in the economic value of its capital due to changes in interest rates be considered by the agency as a factor in evaluating a bank s capital adequacy. The Federal Reserve Board also has issued additional capital guidelines for certain bank holding companies that engage in trading activities. S&T does not believe that consideration of these additional factors will affect the regulators assessment of S&T or S&T Bank s capital position.

Table of Contents

Item 1. BUSINESS continued

Payment of Dividends

S&T is a legal entity separate and distinct from its banking and other subsidiaries. A substantial portion of S&T's revenues consist of dividend payments it receives from S&T Bank. S&T Bank, in turn, is subject to state laws and regulations that limit the amount of dividends it can pay to S&T. In addition, both S&T and S&T Bank are subject to various general regulatory policies relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The Federal Reserve Board has indicated that banking organizations should generally pay dividends only if (1) the organization's net income available to common shareholders over the past year has been sufficient to fund fully the dividends and (2) the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. S&T does not expect that any of these laws, regulations or policies will materially influence S&T or S&T Bank's ability to pay dividends. During the year ended December 31, 2006, S&T Bank paid \$30.0 million in cash dividends to S&T.

Other Safety and Soundness Regulations

There are a number of obligations and restrictions imposed on bank holding companies such as S&T and its depository institution subsidiary by federal law and regulatory policy that are designed to reduce potential loss exposure to the depositors of such depository institutions and to the FDIC insurance funds in the event the depository institution becomes in danger of default or in default. Under current federal law for example, the federal banking agencies possess broad powers to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institution in question is well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized, as defined by the law. Under regulations established by the federal banking agencies, a well capitalized institution must have a Tier 1 capital ratio of at least 6.00 percent, a Total capital ratio of at least 10.00 percent and a leverage ratio of at least 5.00 percent and not be subject to a capital directive order. An adequately capitalized institution must have a Tier 1 capital ratio of at least 4.00 percent, a Total capital ratio of at least 8.00 percent and a leverage ratio of at least 4.00 percent, or 3.00 percent in some cases. As of December 31, 2006, S&T Bank was classified as well capitalized. The classification of depository institutions is primarily for the purpose of applying the federal banking agencies' prompt corrective action provisions and is not intended to be and should not be interpreted as a representation of overall financial condition or prospects of any financial institution.

The federal banking agencies' prompt corrective action powers (which increase depending upon the degree to which an institution is undercapitalized) can include, among other things, requiring an insured depository institution to adopt a capital restoration plan which cannot be approved unless guaranteed by the institution's parent company; placing limits on asset growth and restrictions on activities, including restrictions on transactions with affiliates; restricting the interest rates the institution may pay on deposits; prohibiting the payment of principal or interest on subordinated debt; prohibiting the holding company from making capital distributions without prior regulatory approval; and, ultimately, appointing a receiver for the institution. Among other things, only a well capitalized depository institution may accept brokered deposits without prior regulatory approval. In addition to the foregoing, current Federal Reserve Board policy with respect to bank holding company operations requires a bank holding company to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so otherwise.

The federal banking agencies also have adopted guidelines prescribing safety and soundness standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to

Table of Contents

Item 1. BUSINESS continued

identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, the agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not in compliance with any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the prompt corrective action provisions described above.

Regulatory Enforcement Authority

The enforcement powers available to federal banking agencies are substantial and include, among other things and in addition to other powers described herein, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banks and bank holding companies and institution affiliated parties, as defined in the Federal Deposit Insurance Act (FDIA). In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

The PADB also has broad enforcement powers over S&T Bank, including the power to impose fines and other civil and criminal penalties, and to appoint a conservator or receiver.

Interstate Banking and Branching

The BHCA currently permits bank holding companies from any state to acquire banks and bank holding companies located in any other state, subject to certain conditions, including certain nation-wide and state-imposed deposit concentration limits. S&T Bank has the ability, subject to certain restrictions, to acquire by acquisition or merger, branches of banks located outside of Pennsylvania, its home state. The establishment of de novo interstate branches is also possible in those states where expressly permitted. Once a bank has established branches in a state through an interstate merger transaction, the bank may establish and acquire additional branches at any location in the state where a bank headquartered in that state could have established or acquired branches under applicable federal or state law.

Community Reinvestment and Consumer Protection Laws

In connection with its lending activities, S&T Bank is subject to a number of federal laws designed to protect borrowers and promote lending to various sectors of the economy and population. These include the Equal Credit Opportunity Act, the Truth-in-Lending Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act and the Community Reinvestment Act (the CRA). In addition, rules developed by the federal banking agencies pursuant to federal law require disclosure of privacy policies to consumers and in some circumstances, allow consumers to prevent the disclosure of certain personal information to nonaffiliated third parties.

The CRA requires the appropriate federal banking agency, in connection with its examination of a bank, to assess the bank's record in meeting the credit needs of the communities served by the bank, including low and moderate-income neighborhoods. Furthermore, such assessment also is required of any bank that has applied, among other things, to merge or consolidate with or acquire the assets or assume the liabilities of an insured depository institution, or to open or relocate a branch office. In the case of a bank holding company (including a financial holding

Edgar Filing: S&T BANCORP INC - Form 10-K

company) applying for approval to acquire a bank or bank holding company, the Federal Reserve Board will assess the record of each subsidiary bank of the applicant bank holding company in considering the application. Under the

PAGE 8

Table of Contents

Item 1. BUSINESS continued

CRA, institutions are assigned a rating of outstanding, satisfactory, needs to improve or unsatisfactory. S&T Bank was rated satisfactory in its most recent CRA evaluation.

Anti-Money Laundering Legislation

S&T Bank is subject to the Bank Secrecy Act and its implementing regulations and other anti-money laundering laws and regulations, including the USA PATRIOT Act of 2001. Among other things, these laws and regulations require S&T Bank to take steps to prevent the use of S&T Bank to facilitate the flow of illegal or illicit money, to report large currency transactions and to file suspicious activity reports. S&T Bank also is required to develop and implement a comprehensive anti-money laundering compliance program. Banks also must have in place appropriate know your customer policies and procedures. Violations of these requirements can result in substantial civil and criminal sanctions. In addition, provisions of the USA PATRIOT Act require the federal financial institution regulatory agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing bank mergers and bank holding company acquisitions.

Competition

S&T Bank competes with other local, regional and national financial service providers, such as other financial holding companies, commercial banks, savings associations, credit unions, finance companies and brokerage and insurance firms. The financial service industry is likely to become more competitive as further technological advances enable more companies to provide financial services on a more efficient and convenient basis.

Item 1A. RISK FACTORS

Investments in S&T common stock involve risk. The following discussion highlights risks management believes are material for our company, but does not necessarily include all risks that S&T may face.

The market price of S&T common stock may fluctuate significantly in response to a number of factors, including:

- changes in securities analysts' estimates of financial performance
- volatility of stock market prices and volumes
- changes in market valuations of similar companies
- new products or services offered in the banking and/or financial services industries
- variations in quarterly or annual operating results
- new litigation

Edgar Filing: S&T BANCORP INC - Form 10-K

changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or other regulatory agencies

If S&T does not adjust to changes in the financial services industry, its financial performance may suffer.

S&T's ability to maintain its history of strong financial performance and return on investment to shareholders will depend in part on its ability to expand its scope of available financial services to its customers. In addition to other banks, competitors include security dealers, brokers, mortgage bankers, investment advisors, and finance and insurance companies. The increasingly competitive environment is, in part, a result of changes in regulation, changes in technology and product delivery systems, and the accelerating pace of consolidation among financial service providers.

PAGE 9

Table of Contents

Item 1A. RISK FACTORS continued

Future governmental regulation and legislation could limit our growth.

S&T is subject to extensive state and federal regulation, supervision and legislation that govern nearly every aspect of our operations. Changes to these laws could affect our ability to deliver or expand our services and diminish the value of our business. See Supervision and Regulation for additional information.

Interest rate movements impact the earnings of S&T.

S&T is exposed to interest rate risk, through the operations of its banking subsidiary, since substantially all of S&T Bank's assets and liabilities are monetary in nature. Interest rate risk arises from market driven fluctuations in interest rates that affect cash flows, income, expense and value of financial instruments. S&T Bank's earnings, like that of most financial institutions, largely depend on net interest income, which is the difference between the interest income earned on interest-earning assets, such as loans and investments, and the interest expense paid on interest-bearing liabilities, such as deposits and borrowings. In an increasing interest rate environment, the cost of funds is expected to increase more rapidly than the interest earned on the loans and securities because the primary source of funds are deposits with generally shorter maturities than the maturities on loans and investment securities. This causes the net interest rate spread to compress and negatively impact S&T Bank's profitability.

S&T's business strategy includes growth plans through internal growth and acquisitions. Our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

S&T intends to continue pursuing a profitable growth strategy. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in growth stages of development. We cannot assure you that we will be able to expand our market presence in our existing markets or successfully enter new markets or that any such expansion will not adversely affect our results of operations. Failure to manage our growth effectively could have a material adverse effect on our business, future prospects, financial condition or results of operations and could adversely affect our ability to successfully implement our business strategy. Also, if we grow more slowly than anticipated, our operating results could be materially adversely affected.

Our ability to grow successfully will depend on a variety of factors including the continued availability of desirable business opportunities, the competitive responses from other financial institutions in our market areas and our ability to manage our growth. While we believe we have the management resources and internal systems in place to successfully manage our future growth, there can be no assurance that growth opportunities will be available or that growth will be successfully managed.

Downturn in the local economies may adversely affect our business.

S&T's business is concentrated in the western-Pennsylvania area. As a result, its financial condition, results of operations and cash flows are subject to changes if there are changes in the economic conditions in this area. A prolonged period of economic recession or other adverse economic conditions in this area could have a negative impact on S&T. S&T can provide no assurance that conditions in its market area

economies will not deteriorate in the future and that such deterioration would not have a material adverse effect on S&T.

Item 1B. UNRESOLVED STAFF COMMENTS

There were no unresolved comments received from the SEC regarding S&T's periodic or current reports within the last 180 days prior to December 31, 2006.

PAGE 10

Table of Contents**Item 2. PROPERTIES**

S&T operates 49 banking offices in Allegheny, Armstrong, Blair, Butler, Cambria, Clarion, Clearfield, Indiana, Jefferson, Westmoreland and surrounding counties in Pennsylvania.

S&T owns land and banking offices at the following locations:

| | | | |
|--|---|---|---|
| 133 Philadelphia Street Armagh, PA 15920 | 205 East Market Street Blairsville, PA 15717 | 111 Resort Plaza Drive Blairsville, PA 15717 | 456 Main Street Brockway, PA 15824 |
| 256 Main Street Brookville, PA 15825 | 209 Allegheny Boulevard Brookville, PA 15825 | 100 South Chestnut Street Derry, PA 15627 | 410 Main Street Clarion, PA 16214 |
| 650 Main Street Clarion, PA 16214 | 85 Greensburg Street Delmont, PA 15626 | 200 Patchway Road Duncansville, PA 16635 | 614 Liberty Boulevard DuBois, PA 15801 |
| Coral Reef & Crooked Island Roads DuBois, PA 15801 | 35 West Scribner Avenue DuBois, PA 15801 | 34 North Main Street Homer City, PA 15748 | 420 Pleasantview Drive & Armstrong Street Ford City, PA 16226 |
| 920 Fifth Avenue Ford City, PA 16226 | 701 East Pittsburgh Street Greensburg, PA 15601 | 225 Lucerne Road Lucernemines, PA 15754 | 2175 Route 286 South Indiana, PA 15701 |
| 100 South Fourth Street Youngwood, PA 15697 | 501 Philadelphia Street Indiana, PA 15701 | 2190 Hulton Road Verona, PA 15147 | 4385 Old Wm. Penn Hwy Monroeville, PA 15146 |
| 4251 Old Wm. Penn Hwy Murrysville, PA 15668 | 628 Broad Street New Bethlehem, PA 16242 | 539 West Mahoning Street Punxsutawney, PA 15767 | 12262 Frankstown Road Pittsburgh, PA 15235 |
| 301 Unity Center Road Pittsburgh, PA 15239 | 7660 Saltsburg Road Pittsburgh, PA 15239 | 30 Towne Center Drive Leechburg, PA 15656 | 232 Hampton Avenue Punxsutawney, PA 15767 |
| 418 Main Street Reynoldsville, PA 15851 | 602 Salt Street Saltsburg, PA 15681 | 800 Philadelphia Street Indiana, PA 15701 | 355 North Fifth Street Indiana, PA 15701 |
| 196 Industrial Park Ebensburg, PA 15931 | | | |

S&T leases land where S&T owns the banking offices and remote ATM buildings at the following locations:

| | | | |
|--------------------------------------|-------------------------------------|---|--|
| 8th & Merle Street Clarion, PA 16214 | 2320 Route 286 Pittsburgh, PA 15239 | 523 Franklin Avenue Vandergrift, PA 15690 | 435 South Seventh Street Indiana, PA 15701 |
| 1107 Wayne Avenue Indiana, PA 15701 | 1176 Grant Street Indiana, PA 15701 | 229 Westmoreland Drive, Route 30 Greensburg, PA 15601 | 220 New Castle Road Butler, PA 16001 |
| 835 Hospital Road Indiana, PA 15701 | | | |

Table of Contents

Item 2. PROPERTIES continued

S&T leases land and banking offices at the following locations:

| | | | |
|--|---|---|--|
| 20001 Route 19 Suite B Cranberry Township, PA 16066 | 6700 Hollywood Boulevard Delmont, PA 15626 | 5522 Shaffer Road DuBois Mall DuBois, PA 15801 | 206 East High Street Ebensburg, PA 15931 |
| Lawruk Plaza 208 West Plank Road Altoona, PA 16602 | 324 North Fourth Street Indiana, PA 15701 | 100 Colony Lane Latrobe, PA 15650 | 3884 Route 30 East Latrobe, PA 15650 |
| 3100 Oakland Avenue Indiana, PA 15701 | 12 Hilltop Plaza Kittanning, PA 16201 | Two Gateway Center 603 Stanwix Street, Suite 125 Pittsburgh, PA 15222 | 33 South Sixth Street Indiana, PA 15701 |
| 2388 Route 286 Holiday Park, PA 15239 | Shadyside Village 820 South Aiken Avenue Pittsburgh, PA 15232 | | |

Item 3. LEGAL PROCEEDINGS

The nature of our business generates a certain amount of litigation involving matters arising in the ordinary course of business. However, in management's opinion, there are no proceedings pending to which S&T is a party or to which our property is subject, which, if determined adversely to S&T, would be material in relation to our shareholders' equity or financial condition. In addition, no material proceedings are pending nor are known to be threatened or contemplated against us by governmental authorities or other parties.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters during the fourth quarter of the fiscal year covered by this report that were submitted to a vote of our security holders through solicitation of proxies or otherwise.

Table of Contents**PART II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER****MATTERS AND ISSUER REPURCHASES OF EQUITY SECURITIES****STOCK PRICES AND DIVIDEND INFORMATION**

S&T's common stock is listed on the NASDAQ Global Select Market System (NASDAQ) under the symbol STBA. The range of sale prices for the years 2006 and 2005 are as follows and is based upon information obtained from NASDAQ. As of the close of business January 25, 2007, there were 3,062 shareholders of record of S&T. Dividends paid by S&T are primarily provided from S&T Bank's dividends to S&T. The payment of dividends by S&T Bank to S&T is subject to the restrictions described in Note J to the Consolidated Financial Statements. The cash dividends declared shown below represent the historical per share amounts for S&T Common Stock.

| | Price Range of Common Stock | | Cash Dividends Declared |
|----------------|-----------------------------|----------|-------------------------|
| | Low | High | |
| 2006 | | | |
| Fourth Quarter | \$ 31.14 | \$ 35.60 | \$ 0.30 |
| Third Quarter | 29.67 | 33.25 | 0.29 |
| Second Quarter | 31.93 | 36.68 | 0.29 |
| First Quarter | 35.59 | 37.68 | 0.29 |
| 2005 | | | |
| Fourth Quarter | \$ 33.95 | \$ 39.24 | \$ 0.29 |
| Third Quarter | 35.77 | 40.52 | 0.28 |
| Second Quarter | 33.23 | 37.46 | 0.28 |
| First Quarter | 34.95 | 38.39 | 0.28 |

During 2006, S&T repurchased 1,031,700 shares of its common stock at an average price of \$34.19 per share. The impact of the repurchased shares is a \$0.02 increase to diluted earnings per share. The S&T Board of Directors previously authorized a stock buyback program for 2006 of up to one million shares, or approximately 4 percent of shares outstanding. During 2006, S&T repurchased 999,000 shares under this program at an average cost of \$34.20 per share. On October 16, 2006, the S&T Board of Directors authorized a new stock buyback program until September 30, 2007 of an additional one million shares with 32,700 shares repurchased under this plan during the fourth quarter of 2006 at an average cost of \$33.63 per share. S&T reissued 122,244 shares during 2006 primarily through the exercise of employee stock options.

Table of Contents

Item 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED SHAREHOLDER

MATTERS AND ISSUER REPURCHASES OF EQUITY SECURITIES continued

FIVE-YEAR CUMULATIVE TOTAL RETURN

The following chart compares the cumulative total shareholder return on S&T Common Stock with the cumulative total shareholder return of the NASDAQ Composite Index and ¹NASDAQ Bank Index assuming a \$100 investment in each on December 31, 2001.

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| STBA | \$ 100 | \$ 107 | \$ 132 | \$ 173 | \$ 174 | \$ 169 |
| Nasdaq Composite Index | 100 | 69 | 97 | 107 | 109 | 121 |
| Nasdaq Bank Index | 100 | 107 | 140 | 160 | 157 | 179 |

¹ The NASDAQ Bank Index contains securities of NASDAQ-listed companies classified according to the Industry Classification Benchmark as Banks. They include banks providing a broad range of financial services, including retail banking, loans and money transmissions.

Table of Contents**Item 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED SHAREHOLDER****MATTERS AND ISSUER REPURCHASES OF EQUITY SECURITIES continued**

The following information describes the activity that has taken place during 2006 with respect to S&T's share repurchase plan:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Maximum Number of Shares that Can Be Purchased Under the Plans |
|--|----------------------------------|------------------------------|--|--|
| 01/01/2006 - 01/31/2006 ⁽¹⁾⁽²⁾⁽³⁾ | 40,000 | \$ 36.30 | 40,000 | |
| 02/01/2006 - 02/28/2006 | 33,000 | 36.13 | 33,000 | |
| 03/01/2006 - 03/31/2006 | 131,000 | 35.88 | 131,000 | |
| 04/01/2006 - 04/30/2006 | 175,000 | 35.43 | 175,000 | |
| 05/01/2006 - 05/31/2006 | 225,000 | 35.11 | 225,000 | |
| 06/01/2006 - 06/30/2006 | | | | |
| 07/01/2006 - 07/31/2006 | 100,000 | 31.72 | 100,000 | |
| 08/01/2006 - 08/31/2006 | | | | |
| 09/01/2006 - 09/30/2006 | 295,000 | 32.38 | 295,000 | |
| 10/01/2006 - 10/31/2006 | | | | |
| 11/01/2006 - 11/30/2006 | | | | |
| 12/01/2006 - 12/31/2006 | 32,700 | 33.63 | 32,700 | |
| Total | 1,031,700 | \$ 34.19 | 1,031,700 | 2,000,000 |

(1) The plan was announced on December 20, 2005.

(2) The plan was approved by the S&T Board of Directors for the repurchase of up to one million shares.

(3) The expiration date of the plan is December 31, 2006. On October 16, 2006 the S&T Board of Directors authorized and announced a new stock buyback program until September 30, 2007 for an additional one million shares.

Item 6. SELECTED FINANCIAL DATA

| Year Ended December 31: | 2006 | 2005 | 2004 | 2003 | 2002 |
|--|------------------|------------------|------------------|------------------|------------------|
| <i>(dollars in thousands, except per share data)</i> | | | | | |
| INCOME STATEMENTS | | | | | |
| Interest income | \$ 204,702 | \$ 172,122 | \$ 148,638 | \$ 151,460 | \$ 151,160 |
| Interest expense | 91,584 | 59,514 | 40,890 | 47,066 | 56,300 |
| Provision for loan losses | 9,380 | 5,000 | 4,400 | 7,300 | 7,800 |
| Net interest income after provision for loan losses | 103,738 | 107,608 | 103,348 | 97,094 | 87,060 |
| Noninterest income | 40,390 | 37,386 | 34,401 | 36,204 | 32,680 |
| Noninterest expense | 69,279 | 62,464 | 60,390 | 60,658 | 51,766 |
| Income before taxes | 74,849 | 82,530 | 77,359 | 72,640 | 67,974 |
| Applicable income taxes | 21,513 | 24,287 | 23,001 | 20,863 | 19,370 |
| Net income | \$ 53,336 | \$ 58,243 | \$ 54,358 | \$ 51,777 | \$ 48,604 |
| PER SHARE DATA | | | | | |
| Net income Basic | \$ 2.07 | \$ 2.21 | \$ 2.05 | \$ 1.96 | \$ 1.83 |
| Net income Diluted | 2.06 | 2.18 | 2.03 | 1.94 | 1.81 |
| Dividends declared | 1.17 | 1.13 | 1.07 | 1.02 | 0.97 |
| Book Value | 13.37 | 13.41 | 13.12 | 12.48 | 11.51 |

Table of Contents**Item 6. SELECTED FINANCIAL DATA continued****SELECTED FINANCIAL DATA****BALANCE SHEET TOTALS (PERIOD END):**

| Year Ended December 31: <i>(dollars in thousands)</i> | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|--------------|--------------|--------------|--------------|--------------|
| Total assets | \$ 3,338,543 | \$ 3,194,979 | \$ 2,989,034 | \$ 2,900,272 | \$ 2,823,867 |
| Securities available for sale | | | | | |
| | 432,045 | 481,257 | 503,218 | 594,179 | 624,971 |
| Other investments | 10,562 | 13,318 | 14,953 | 16,904 | 16,193 |
| Net loans | 2,633,071 | 2,454,934 | 2,253,089 | 2,069,142 | 1,968,755 |
| Total deposits | 2,565,306 | 2,418,884 | 2,176,263 | 1,962,253 | 1,926,119 |
| Securities sold under repurchase agreements and federal funds purchased | 133,021 | 137,829 | 98,384 | 182,020 | 194,388 |
| Short-term borrowings | 55,000 | 150,000 | 225,000 | 250,000 | 125,000 |
| Long-term borrowings | 171,941 | 83,776 | 86,325 | 116,933 | 211,693 |
| Junior subordinated debt securities | 25,000 | | | | |
| Total shareholders' equity | 339,051 | 352,421 | 349,129 | 332,718 | 306,114 |

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**OVERVIEW**

S&T is a financial holding company with its headquarters located in Indiana, Pennsylvania with assets of approximately \$3.3 billion at December 31, 2006. S&T provides a full range of financial services through a branch network of 49 offices located in Allegheny, Armstrong, Blair, Butler, Cambria, Clarion, Clearfield, Indiana, Jefferson and Westmoreland counties of Pennsylvania. S&T provides full service retail and commercial banking products as well as cash management services; insurance; estate planning and administration; employee benefit investment management and administration; corporate services; and other fiduciary services. S&T earns revenue primarily from interest on loans, security investments and fees charged for financial services provided to our customers. Offsetting these revenues are the cost of deposits and other funding sources, provision for loan losses as well as other operating costs such as: salaries and employee benefits, occupancy, data processing expenses and tax expense. Balance sheet growth in 2006 included a 7 percent increase in commercial lending activities, a 9 percent increase in consumer and residential mortgage loans with funding for that growth provided primarily by a 6 percent increase in deposits. S&T's strategic plan to deliver profitable growth to our shareholders includes: increasing loans and core deposits with sufficient interest rate spreads, controlling loan delinquency and loan losses, controlling operating expenses and expanding the business through new de novo branching, merger and acquisitions, introduction of new products and services, and expansion of our products and services provided to our existing customers.

There are many uncertainties regarding the economy as S&T enters 2007. S&T continually strives to be well positioned for changes in both the economy and interest rates, regardless of the timing or direction of these changes. Management continually assesses our balance sheet, capital, liquidity and operation infrastructures in order to be positioned to take advantage of internal or acquisition growth opportunities.

There are many factors that could influence our results, both positively and negatively, in 2007. Because the majority of our revenue comes from net interest income, internally generated loan and deposit growth and the mix of that growth are major factors on our operations and financial condition. S&T has directed a fair amount of focus and resources in planning for 2007 to improve our generation and retention of low cost core deposits. On the other hand, a slowing economy could cause

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

deterioration in the asset quality measurements. S&T recognizes that our shift to a greater dependence on commercial loans in recent years exposes us to larger credit risks and greater swings in nonperforming loans and loan charge-offs when problems do occur. However, because of our earnings strength and strong capitalization, as well as the strengths of other businesses in our market area, management does not expect a decline in our ability to satisfactorily perform if a further decline in our economy occurs.

FINANCIAL CONDITION

Average earning assets increased by \$166.6 million in 2006 primarily as a result of growth in commercial lending, consumer and residential mortgage activities. During 2006, average loan balances increased by \$217.3 million, and average securities, other investments and federal funds sold decreased \$50.7 million. The funding for this loan growth was primarily provided by a \$249.1 million increase in average deposits, offset by a decrease of \$4.6 million in average earnings retained and a \$68.6 million decrease in average borrowings.

| Loans (dollars in millions) | 2006 | | 2005 | |
|-------------------------------------|-------------------------|---------------------------------------|----------------------------|---------------------------------------|
| | Average Loan Balance | Average Loan Balance Percentage | Average Loan Balance | Average Loan Balance Percentage |
| Commercial, mortgage and industrial | \$ 1,972.7 | 76% | \$ 1,809.5 | 76% |
| Residential real estate mortgage | 545.8 | 21% | 492.7 | 21% |
| Installment | 69.7 | 3% | 68.7 | 3% |
| Total | \$ 2,588.2 | 100% | \$ 2,370.9 | 100% |

LENDING ACTIVITY

Average loans for the year ended December 31, 2006 were \$2.6 billion, a \$217.3 million or 9 percent increase from the year ended December 31, 2005. The increase in average loans for 2005 compared to the year ended 2004 was \$145.5 million. Changes in the composition of the average loan portfolio during 2006 included increases of \$163.2 million in commercial loans and \$53.1 million in residential mortgage loans and an increase of \$1.0 million in installment loans. Changes in the composition of the average loan portfolio during 2005 included increases of \$145.3 million in commercial loans and \$3.4 million in residential mortgage loans, offset by a decrease of \$3.2 million in installment loans. Total loans at December 31, 2006 increased \$174.8 million from December 31, 2005. The increase is primarily attributable to the growth of \$124.1 million in commercial loans, \$45.8 million in residential mortgage loans and \$4.9 million in consumer loans.

Average real estate construction and commercial loans, including commercial and industrial, comprised 76 percent of the loan portfolio in 2006 and 2005. Commercial loans continued to be an area of strategic growth during 2006 and 2005. Although commercial loans can have a relatively higher risk profile, management believes these risks are mitigated through active portfolio management, underwriting and continuous review. At December 31, 2006, variable-rate commercial loans were 49 percent of the commercial loan portfolio as compared to 55 percent at December 31, 2005.

Average residential mortgage loans comprised 21 percent of the loan portfolio in 2006 and 2005. Residential mortgage lending continued to be a strategic focus during 2006 through a centralized mortgage origination department, ongoing product redesign, secondary market activities and the utilization of commission compensated originators. Management believes that if a downturn in the local residential real estate market occurs,

the impact of declining values on the real estate loan

PAGE 17

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

portfolio will be mitigated because of S&T's conservative mortgage lending policies for portfolio loans, which generally require a maximum term of 20 years for fixed-rate mortgages, a maximum term of 30 years for adjustable-rate mortgages and private mortgage insurance for loans with less than a 20 percent down payment. Adjustable-rate mortgages with repricing terms of one, three and five years comprised 10 percent of the residential mortgage portfolio in 2006 and 13 percent in 2005. Home equity loans increased \$42.4 million during 2006 and \$34.7 million in 2005 and totaled \$269.9 million at December 31, 2006 and \$227.5 million at December 31, 2005. The increase in home equity loans is primarily attributable to successful marketing programs during 2006 and 2005.

S&T periodically designates specific loan originations, generally longer-term, lower-yielding 1-4 family mortgages as held for sale and sells them to Fannie Mae. The intent of these sales is to mitigate interest-rate risk associated with holding long-term residential mortgages in the loan portfolio, generate fee revenue from servicing, and maintain the primary customer relationship. During 2006, S&T sold \$18.8 million of 1-4 family mortgage loans to Fannie Mae and currently services \$180.8 million of secondary market mortgage loans. Fees and gains from mortgage servicing activities were \$0.7 million in 2006 and \$1.5 million in 2005. Management intends to continue to sell longer-term loans to Fannie Mae in the future on a selective basis, especially during periods of lower interest rates.

Average consumer installment loans comprised 3 percent of the loan portfolio in 2006 and 2005. Installment loan increases during 2006 were primarily the result of successful marketing programs during 2006. The balance of consumer installment loans at December 31, 2006 was \$73.1 million compared to \$68.2 million at December 31, 2005.

Loan underwriting standards for S&T are established by a formal policy administered by the S&T Bank Loan Administration Department, and are subject to the periodic review and approval by our Board of Directors.

Rates and terms for commercial real estate, equipment loans and commercial lines of credit normally are negotiated, subject to such variables as financial condition of the borrower, economic conditions, marketability of collateral, credit history of the borrower and future cash flows. The loan to value policy guidelines for commercial real estate loans is generally 65-80 percent.

The loan to value policy guidelines for residential, first lien, mortgage loans is 80 percent. Higher loan to value loans may be approved with the appropriate private mortgage insurance coverage. Second lien positions are sometimes assumed with home equity loans, but normally only to the extent that the combined credit exposure for both first and second liens does not exceed 100 percent of the fair market value of the mortgage property.

We offer a variety of unsecured and secured installment loan and credit card products. Loan to value policy guidelines for direct loans are 90-100 percent of invoice for new automobiles and 80-90 percent of National Automobile Dealer Association (NADA) value for used automobiles.

The following table shows S&T's loan distribution at the end of each of the last five years:

| | December 31 | | | | |
|-------------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| <i>(dollars in thousands)</i> | | | | | |
| Domestic Loans: | | | | | |
| Commercial, mortgage and industrial | \$ 1,675,848 | \$ 1,565,035 | \$ 1,455,932 | \$ 1,328,378 | \$ 1,169,138 |
| Real estate - construction | 352,482 | 339,179 | 274,783 | 193,874 | 191,927 |
| Real estate - mortgage | 564,821 | 519,076 | 487,445 | 499,661 | 541,102 |
| Installment | 73,140 | 68,216 | 69,191 | 78,707 | 96,726 |
| TOTAL LOANS | \$ 2,666,291 | \$ 2,491,506 | \$ 2,287,351 | \$ 2,100,620 | \$ 1,998,893 |

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

The following table shows the maturity of loans (excluding residential mortgages of 1-4 family residences and installment loans) outstanding as of December 31, 2006. Also provided are the amounts due after one year classified according to the sensitivity to changes in interest rates.

| | Within One Year | Maturing After One But Within Five Years | After Five Years | Total |
|-------------------------------------|--------------------|--|---------------------|---------------------|
| <i>(dollars in thousands)</i> | | | | |
| Commercial, mortgage and industrial | \$ 485,924 | \$ 502,447 | \$ 687,477 | \$ 1,675,848 |
| Real estate construction | 148,968 | 130,178 | 73,336 | 352,482 |
| TOTAL | \$ 634,892 | \$ 632,625 | \$ 760,813 | \$ 2,028,330 |
| Fixed interest rates | | \$ 200,335 | \$ 133,983 | |
| Variable interest rates | | 432,290 | 626,830 | |
| TOTAL | | \$ 632,625 | \$ 760,813 | |

SECURITIES ACTIVITY

Average securities and other investments decreased \$49.8 million in 2006 and decreased \$57.7 million in 2005. The largest components of the 2006 decrease included \$24.6 million in U.S. government agency securities, \$8.6 million in marketable equity securities, \$7.7 million of mortgage-backed securities, \$6.8 million of corporate securities and \$2.9 million in treasury securities. Average other investments decreased \$3.4 million in 2006 as compared to the 2005 full year average and is comprised of Federal Home Loan Bank (FHLB) stock that is a membership and borrowing requirement and is recorded at historical cost. The amount of S&T's investment in FHLB stock depends upon S&T's borrowing availability and level from the FHLB. Offsetting these decreases was an average increase of \$4.2 million of states and political subdivisions. The largest components of the 2005 decrease included \$67.5 million in U.S. government agency securities, \$8.6 million of corporate securities and \$2.1 million in treasury securities. Average other investments decreased \$2.9 million in 2005 as compared to the 2004 full year average and is comprised of FHLB stock. Offsetting these decreases were average increases of \$13.2 million of mortgage-backed securities and \$10.2 million of states and political subdivisions. Both the decreases in securities in 2006 and 2005 are partially attributable to a S&T Asset Liability Committee (ALCO) strategy to reduce balances in both securities and borrowings to mitigate the interest rate risk of a flat or inverted yield curve.

The equity securities portfolio is primarily comprised of bank holding companies. At December 31, 2006, the equity securities portfolio had a total market value of \$55.3 million and net unrealized gains of \$16.1 million. The equity securities portfolio consists of securities traded on the various stock markets and is subject to changes in market value.

S&T's policy for security classification includes U.S. treasury securities, U.S. government corporations and agencies, mortgage-backed securities, collateralized mortgage obligations, states and political subdivisions, corporate securities, marketable equity securities and other securities as available for sale. On a quarterly basis, management evaluates the securities portfolios for other-than-temporary declines in market value in accordance with FSP 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. During 2006, there were \$0.3 million of realized losses taken for other-than-temporary impairments on three equity investment securities. The performance of the equities and debt securities markets could generate further impairment in future periods. At December 31, 2006, net unrealized gains on securities classified as available for sale, including equity securities, were approximately \$9.8 million as compared to \$13.5 million at December 31, 2005. S&T has the intent and ability to hold these debt and equity securities until maturity or until market value recovers above cost.

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

S&T invests in various securities in order to provide a source of liquidity, increase net interest income and as a tool of ALCO to quickly reposition the balance sheet for interest rate risk purposes. Securities are subject to similar interest rate and credit risks as loans. In addition, by their nature, securities classified as available for sale are also subject to market value risks that could negatively affect the level of liquidity available to S&T, as well as equity.

Risks associated with various securities portfolios are managed and monitored by investment policies annually approved by the S&T Board of Directors, and administered through ALCO and the Treasury function of S&T Bank. As of December 31, 2006, management is not aware of any risk associated with securities that would be expected to have a significant, negative effect on S&T's statement of condition or statement of operations.

The following table sets forth the carrying amount of securities at the dates indicated:

| | December 31 | | |
|--|-------------------|-------------------|-------------------|
| | 2006 | 2005 | 2004 |
| <i>(dollars in thousands)</i> | | | |
| Available for Sale | | | |
| Marketable equity securities | \$ 55,349 | \$ 65,114 | \$ 74,555 |
| Obligations of U.S. government corporations and agencies | 180,003 | 221,037 | 237,514 |
| Collateralized mortgage obligations of U.S. government corporations and agencies | 60,090 | 63,639 | 46,528 |
| Mortgage-backed securities | 31,793 | 38,416 | 48,373 |
| U.S. treasury securities | | 499 | 5,248 |
| Obligations of states and political subdivisions | 81,672 | 83,811 | 71,198 |
| Corporate securities | | | 16,493 |
| Other securities | 23,138 | 8,741 | 3,044 |
| TOTAL | \$ 432,045 | \$ 481,257 | \$ 502,953 |
| Held to Maturity | | | |
| Obligations of states and political subdivisions | \$ | \$ | \$ 265 |
| TOTAL | \$ | \$ | \$ 265 |

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

The following table sets forth the maturities of securities at December 31, 2006, and the weighted average yields of such securities (calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of debt securities and estimated prepayment rates on most mortgage-backed securities). Tax-equivalent adjustments (using a 35 percent federal income tax rate) for 2006 have been made in calculating yields on obligations of states and political subdivisions.

| | Within | | Maturing | | | | After | | No Fixed Maturity Amount |
|--|--------------------|--------------|---|--------------|---|--------------|------------------------------|--------------|-----------------------------------|
| | One Year Amount | Yield | After One But Within Five Years Amount | Yield | After Five But Within Ten Years Amount | Yield | After Ten Years Amount | Yield | |
| <i>(dollars in thousands)</i> | | | | | | | | | |
| Available for Sale | | | | | | | | | |
| Marketable equity securities | \$ | | \$ | | \$ | | \$ | | \$ 55,349 |
| Obligations of U.S. government corporations and agencies | 37,677 | 3.48% | 142,327 | 4.08% | | | | | |
| Collateralized mortgage obligations of U.S. government corporations and agencies | 7,443 | 4.44% | 44,144 | 4.75% | 8,503 | 4.67% | | | |
| Mortgage-backed securities | 5,097 | 4.71% | 16,048 | 4.57% | 8,197 | 4.49% | 2,451 | 4.83% | |
| Obligations of states and political subdivisions | 5,840 | 5.31% | 54,392 | 4.73% | 21,155 | 5.34% | 284 | 5.86% | |
| Other securities | | | | | | | | | 23,138 |
| TOTAL | \$ 56,057 | | \$ 256,911 | | \$ 37,855 | | \$ 2,735 | | \$ 78,487 |
| Weighted Average Rate | | 3.91% | | 4.36% | | 5.01% | | 4.93% | |

NONINTEREST EARNING ASSETS

Average noninterest earning assets increased \$20.9 million in 2006 and \$11.1 million in 2005. The 2006 increase was primarily attributable to increases in cash and due from banks, premises and equipment due to the addition of new branches and administrative facilities during 2006 and accrued interest receivable on a higher earning asset balance. The 2005 increase of \$11.1 million was primarily attributable to increases in cash and due from banks, premises and equipment due to the addition of new branches during 2005 and accrued interest receivable on a higher earning asset balance.

ALLOWANCE FOR LOAN LOSSES

The balance in the allowance for loan losses decreased to \$33.2 million or 1.25 percent of total loans at December 31, 2006 as compared to \$36.6 million or 1.47 percent of total loans at December 31, 2005. The decrease in the allowance for loan losses is primarily attributable to three commercial loans that were charged-off during 2006 totaling \$11.4 million. During the second quarter of 2005,

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

S&T split its allowance for credit losses into an allowance for loan losses and an allowance for lending-related commitments such as unfunded commercial real estate and commercial and industrial term loan commitments. The allowance for lending-related commitments is included in other liabilities. This resulted in a decrease in the allowance for loan losses of \$1.0 million and reduction in the allowance for loan losses to total loans from 1.44 percent to 1.40 percent at June 30, 2005. The allowance for lending-related commitments is computed using a methodology similar to that used to determine the allowance for loan losses. Amounts are added to the allowance for lending-related commitments through a charge to current earnings through noninterest expense. The balance in the allowance for lending-related commitments increased to \$1.2 million at December 31, 2006 as compared to \$0.8 million at December 31, 2005.

Management evaluates the degree of loss exposure for loans on a continuous basis through a formal allowance for loan loss policy as administered by S&T Bank's Loan Administration Department and various management and director committees. Problem loans are identified and continually monitored through detailed reviews of specific commercial loans, and the analysis of delinquency and charge-off levels of consumer loan portfolios. Charged-off and recovered loan amounts are applied to the allowance for loan losses. Monthly updates are presented to the S&T Board of Directors as to the status of loan quality. Amounts are added to the allowance for loan losses through a charge to current earnings through the provision for loan losses, based upon management's assessment of the adequacy of the allowance for loan losses for probable loan losses. A quantitative analysis is utilized to support the adequacy of the allowance for loan losses. This analysis includes review of the historical charge-off rates for all loan categories, fluctuations and trends in various risk factors. Factors consider the level of S&T's historical charge-offs that have occurred within the credits' economic life cycle. Management also assesses qualitative factors such as portfolio credit trends, unemployment trends, vacancy trends, loan growth and variable interest rate factors.

Significant to this analysis and assessment is the shift in loan portfolio composition to an increased mix of commercial loans. These loans are generally larger in size and, due to our continuing growth, many are not well seasoned and could be more vulnerable to an economic slowdown. Management relies on its risk rating process to monitor trends, which may be occurring relative to commercial loans to assess potential weaknesses within specific credits. Current risk factors, trends in risk ratings and historical charge-off experiences are considered in the determination of the allowance for loan losses. During 2006, the risk rating profile of the portfolio was impacted by three commercial loans. Two of these loan relationships have combined remaining loan balances of \$7.5 million, and we believe that the problem loans have been adequately reserved at December 31, 2006 and that the total allowance for loan losses is adequate to absorb probable loan losses as determined by the quarterly impairment analysis and risk-rating processes. The third credit has no remaining exposure and future collateral recovery is expected to be insignificant. The remaining risk rating profile of the portfolio has shown overall improvement absent the aforementioned loan relationships.

The allowance for loan losses is established based on management's assessment of the factors noted above along with the growth in the loan portfolio. The additions to the allowance charged to operating expense has maintained the allowance as a percent of loans at the following levels at the end of each year presented below:

| | Year Ended December 31 | | | |
|-------|------------------------|-------|-------|-------|
| 2006 | 2005 | 2004 | 2003 | 2002 |
| 1.25% | 1.47% | 1.50% | 1.50% | 1.51% |

We have considered impaired loans in our determination of the allowance for loan losses. The allowance for loan losses for all impaired loans was \$2,627,000 and \$9,937,000 at December 31, 2006 and 2005, respectively.

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

This table summarizes our loan loss experience for each of the five years presented below:

| | Year Ended December 31 | | | | |
|---|------------------------|------------------|------------------|------------------|------------------|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| <i>(dollars in thousands)</i> | | | | | |
| Balance at January 1: | \$ 36,572 | \$ 34,262 | \$ 31,478 | \$ 30,138 | \$ 26,926 |
| Charge-offs: | | | | | |
| Commercial, mortgage and industrial | 12,575 | 2,260 | 5,616 | 5,208 | 6,131 |
| Real estate mortgage | 394 | 529 | 484 | 905 | 588 |
| Installment | 1,069 | 1,140 | 1,075 | 1,193 | 1,102 |
| Total | 14,038 | 3,929 | 7,175 | 7,306 | 7,821 |
| Recoveries: | | | | | |
| Commercial, mortgage and industrial | 640 | 1,699 | 4,835 | 624 | 1,118 |
| Real estate mortgage | 201 | 235 | 408 | 384 | 349 |
| Installment | 465 | 274 | 316 | 338 | 345 |
| Total | 1,306 | 2,208 | 5,559 | 1,346 | 1,812 |
| Net charge-offs | 12,732 | 1,721 | 1,616 | 5,960 | 6,009 |
| Provision for loan losses | 9,380 | 5,000 | 4,400 | 7,300 | 7,800 |
| Allowance for lending-related commitments | | (969) | | | |
| Loan loss reserve from acquisition | | | | | 1,421 |
| Balance at December 31: | \$ 33,220 | \$ 36,572 | \$ 34,262 | \$ 31,478 | \$ 30,138 |
| Ratio of net charge-offs to average loans outstanding | 0.49% | 0.07% | 0.07% | 0.29% | 0.34% |

This table shows allocation of the allowance for loan losses as of the end of each of the last five years:

| | 2006 | | 2005 | | December 31 2004 | | 2003 | | 2002 | |
|-------------------------------------|------------------|--|------------------|--|---------------------|--|------------------|--|------------------|--|
| | Percent | | Percent | | Percent | | Percent | | Percent | |
| | Amount | of Loans in Each Category to Total Loans | Amount | of Loans in Each Category to Total Loans | Amount | of Loans in Each Category to Total Loans | Amount | of Loans in Each Category to Total Loans | Amount | of Loans in Each Category to Total Loans |
| <i>(dollars in thousands)</i> | | | | | | | | | | |
| Commercial, mortgage and industrial | \$ 28,540 | 63% | \$ 32,053 | 63% | \$ 29,594 | 64% | \$ 26,947 | 63% | \$ 26,002 | 58% |
| Real estate construction | 379 | 13% | 532 | 14% | 852 | 12% | 843 | 9% | 664 | 10% |
| Real estate mortgage | 536 | 21% | 613 | 21% | 585 | 21% | 558 | 24% | 685 | 27% |
| Installment | 3,765 | 3% | 3,374 | 2% | 3,231 | 3% | 3,009 | 4% | 2,671 | 5% |
| Unallocated | | | | 0% | | 0% | 121 | 0% | 116 | 0% |
| TOTAL | \$ 33,220 | 100% | \$ 36,572 | 100% | \$ 34,262 | 100% | \$ 31,478 | 100% | \$ 30,138 | 100% |

Net loan charge-offs totaled \$12.7 million in 2006 and \$1.7 million in 2005. Net loan charge-offs increased during 2006 due to three commercial loan relationships that were charged-off during the period. The first relationship is a commercial construction company that was charged-down by \$7.2 million during the third quarter of 2006. The relationship had a specific reserve assigned of \$7.1 million at the time it was charged down.

Edgar Filing: S&T BANCORP INC - Form 10-K

S&T had previously provided \$5.1 million in 2005 and provided an additional \$2.0 million in the second quarter of 2006. The borrower continues to operate,

PAGE 23

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

but has experienced significant cash flow problems. The borrower has restricted ability to obtain new contracts and may be at-risk to continue as a going concern. The remaining \$5.6 million loan balance on this relationship is believed to be adequately collateralized which includes receivables, equipment and personal guarantees. The second relationship is a \$4.6 million mixed-use, commercial real estate loan participation with another financial institution, previously classified as nonaccrual, which was charged-down by \$2.7 million during the second quarter of 2006. The commercial real estate company filed a voluntary chapter eleven bankruptcy petition during the second quarter of 2006. The remaining \$1.8 million exposure is the estimated fair market value S&T expects to receive in sale proceeds based upon our percentage participation in the loan. The credit is on nonaccrual status at December 31, 2006. The third relationship is a wholesale distributor that filed a voluntary chapter eleven bankruptcy petition during the second quarter of 2006 after failing to obtain expected and significant new contracts and was previously classified as nonaccrual. A charge-off of \$1.5 million was recorded during the second quarter of 2006 for this loan. No further exposure remains for this credit and future collateral recovery is expected to be insignificant.

The balance of nonaccrual loans past due 90 days or more, at December 31, 2006, was \$19.9 million or 0.74 percent of total loans. This compares to nonaccrual loans of \$11.2 million or 0.45 percent of total loans at December 31, 2005. Nonperforming assets totaled \$20.4 million or 0.61 percent of total assets at December 31, 2006 as compared to \$14.9 million or 0.47 percent at December 31, 2005. The most significant credits in nonperforming status at December 31, 2006 is a \$5.6 million residual balance of the aforementioned commercial construction company and the \$1.8 million residual balance related to the aforementioned mixed-use commercial real estate credit. Also affecting nonaccrual loans at December 31, 2006 was a \$1.0 million loan relationship with an energy-related company. Two other \$3.1 million loan relationships were classified as nonaccrual at December 31, 2006, but were fully resolved in January 2007. Also affecting nonperforming assets is a \$3.2 million reduction in property acquired through foreclosure during 2006. The reduction is primarily attributable to a \$2.4 million residential development property acquired in the fourth quarter of 2005, charged down to \$1.5 million in the second quarter of 2006 that was sold for \$1.6 million during the fourth quarter of 2006.

The provision for loans losses was \$9.4 million for 2006, as compared to \$5.0 million for 2005. The provision was the result of management's detailed fourth quarter analysis of the adequacy of the allowance for loan losses and is consistent with the significant increase in nonaccrual loans that occurred as result of the aforementioned loan relationships.

The following table summarizes our nonaccrual and past due loans:

| | December 31 | | | | |
|---|-------------|-----------|----------|----------|----------|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| <i>(dollars in thousands)</i> | | | | | |
| Nonaccrual loans | \$ 19,852 | \$ 11,166 | \$ 6,309 | \$ 9,120 | \$ 5,831 |
| Accruing loans past due 90 days or more | | | | | |

It is S&T's policy to place loans in all categories on nonaccrual status when collection of interest or principal is doubtful, or generally when interest or principal payments are 90 days or more past due. There are no loans 90 days or more past due and still accruing. At December 31, 2006 and 2005, interest that would have been recorded had the nonaccrual loans performed in accordance with the original loan terms would have been \$1,642,000 and \$565,000, respectively. The accrual of interest on impaired loans is discontinued when the loan is 60 days past due or, in management's opinion, the account should be placed on nonaccrual status. At December 31, 2006 and 2005, there was \$8,617,000 and \$5,507,000, respectively, of impaired loans that were on nonaccrual. There are no foreign loan amounts required to be included in this table. There were no restructured loans in the periods presented.

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued****DEPOSITS**

Average total deposits increased by \$261.6 million in 2006 and \$217.7 million in 2005. The mix of average deposits changed in 2006 with average time deposits increasing \$25.4 million and average savings accounts increasing \$327.1 million. Partially offsetting these increases is a decrease of \$103.4 million in average money market and NOW accounts. Average noninterest-bearing deposits increased by \$12.5 million or 3 percent in 2006 and were approximately 17 percent and 18 percent of average total deposits during 2006 and 2005, respectively. The increase in savings accounts is primarily attributable to the success of the Green Plan savings account, which had grown to \$641.9 million at December 31, 2006 since its introduction in August 2004. The Green Plan account was indexed to the Federal Funds Target Rate. During the first quarter of 2006, S&T introduced another high yield savings account to replace the Green Plan account called the Plan B account. After the introduction of the Plan B account, no further Green Plan accounts were opened. Plan B accounts were non-indexed and were expected to allow S&T to continue core deposit growth that better compliments shifting interest rate sensitivity. The S&T Cash Management account is similar to the Plan B account and was introduced in November 2006; both are non-indexed, but the S&T Cash Management account has the added feature of tiering, or the payment of higher rates on higher balances. At December 31, 2006, S&T Cash Management accounts, Green Plan and Plan B balances outstanding were \$743.5 million. As of January 2, 2007, Green Plan and Plan B account balances were transferred to the new S&T Cash Management account. Core deposit growth has been an important strategic initiative for S&T, through the expansion of retail facilities, promotions and new products. Other important strategies include providing cash management services to commercial customers to increase transaction related deposits, and delivery services such as electronic banking. Total deposits at December 31, 2006 increased \$146.4 million compared to December 31, 2005.

The daily average amount of deposits and rates paid on such deposits is summarized for the periods indicated in the following table:

| | 2006 | | Year Ended December 31 2005 | | 2004 | |
|-------------------------------------|---------------------|-------|--------------------------------|-------|---------------------|-------|
| | Amount | Rate | Amount | Rate | Amount | Rate |
| <i>(dollars in thousands)</i> | | | | | | |
| Noninterest-bearing demand deposits | \$ 423,808 | | \$ 411,236 | | \$ 391,885 | |
| NOW/Money market accounts | 334,987 | 1.13% | 438,356 | 0.87% | 538,471 | 0.61% |
| Savings deposits | 829,700 | 3.95% | 502,641 | 2.24% | 235,926 | 0.63% |
| Time deposits | 914,621 | 4.04% | 889,261 | 3.34% | 857,534 | 3.02% |
| TOTAL | \$ 2,503,116 | | \$ 2,241,494 | | \$ 2,023,816 | |

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

| | 2006 |
|--------------------------------|-------------------|
| <i>(dollars in thousands)</i> | |
| Three months or less | \$ 86,464 |
| Over three through six months | 80,028 |
| Over six through twelve months | 45,622 |
| Over twelve months | 49,532 |
| TOTAL | \$ 261,646 |

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

Management believes that the S&T deposit base is stable and that S&T has the ability to attract new deposits, mitigating a funding dependency on other more volatile sources. Special rate deposits of \$100,000 and over were 10 percent and 9 percent of total deposits at December 31, 2006 and 2005, respectively, and primarily represent deposit relationships with local customers in our market area. In addition, management believes that S&T has the ability to access both public and private markets to raise long-term funding if necessary. At December 31, 2006, S&T had \$2.8 million of brokered retail certificates of deposit outstanding compared to \$57.2 million at December 31, 2005. The purchase of brokered retail certificates of deposits in 2006 and 2005 was an ALCO strategy to increase liquidity for commercial loan demand, as an alternative to increased borrowings.

BORROWINGS

Average borrowings by S&T decreased \$68.6 million in 2006 as a result of increased deposit growth and lower levels of investment securities. Borrowings were comprised of retail repurchase agreements (REPOs), wholesale REPOs, federal funds purchased, FHLB advances and long-term borrowings. S&T defines REPOs with our retail customers as retail REPOs; wholesale REPOs are those transacted with other banks and brokerage firms with terms normally ranging from one to 365 days.

The average balance in retail REPOs increased by \$1.5 million in 2006 and \$7.7 million in 2005. S&T views retail REPOs as a relatively stable source of funds because most of these accounts are with local, long-term customers.

Wholesale REPOs, federal funds purchased and FHLB advances averaged \$140.3 million in 2006, a decrease of \$153.0 million from the 2005 averages. The decrease is attributable to the increase in deposits in 2006, which decreased our need for additional funds.

During 2006, average long-term borrowings increased \$82.8 million as compared to December 31, 2005. At December 31, 2006, S&T had long-term borrowings outstanding of \$168.8 million at a fixed-rate and \$3.1 million at a variable rate with the FHLB. The increase in long-term borrowings is part of an ALCO strategy to limit interest rate risk as customer preferences have shifted to short-term and variable rate deposits, and to take advantage of lower cost funds through the FHLB's Community Investment Program.

During the third quarter of 2006, S&T Bank issued \$25.0 million of junior subordinated debentures through a pooled transaction at an initial fixed rate of 6.78 percent. On September 15, 2011 and quarterly thereafter, S&T Bank has the option to redeem the subordinated debt, subject to a 30 day written notice and prior approval by the FDIC. If S&T Bank chooses not to exercise the option for early redemption on September 15, 2011 or subsequent quarters, the subordinated debt will convert to a variable rate of 3-month LIBOR plus 160 basis points. The subordinated debt qualifies as Tier 2 capital under regulatory guidelines and will mature on December 15, 2036.

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

The following table shows the distribution of our short-term borrowings and the weighted average interest rates thereon at the end of each of the last three years. Also provided are the maximum amount of borrowings and the average amounts of borrowings as well as weighted average interest rates for the last three years.

| Securities Sold under Repurchase Agreements and Federal Funds Purchased <i>(dollars in thousands)</i> | 2006 | 2005 | 2004 |
|---|-------------|-------------|-------------|
| Balance at December 31 | \$ 133,021 | \$ 137,829 | \$ 98,384 |
| Average balance during the year | 114,544 | 132,406 | 164,645 |
| Average interest rate during the year | 4.51% | 2.98% | 1.16% |
| Maximum month-end balance during the year | \$ 156,471 | \$ 174,467 | \$ 199,538 |
| Average interest rate at year-end | 4.83% | 3.80% | 1.77% |
| Federal Home Loan Bank (FHLB) Advances <i>(dollars in thousands)</i> | 2006 | 2005 | 2004 |
| Balance at December 31 | \$ 55,000 | \$ 150,000 | \$ 225,000 |
| Average balance during the year | 88,342 | 221,918 | 293,391 |
| Average interest rate during the year | 5.01% | 3.21% | 1.47% |
| Maximum month-end balance during the year | \$ 150,000 | \$ 315,000 | \$ 380,000 |
| Average interest rate at year-end | 5.44% | 4.34% | 2.20% |

WEALTH MANAGEMENT ASSETS

The year-end 2006 market value balance of the S&T Bank wealth management assets under management, which are not accounted for as part of the assets of S&T, increased 12 percent in 2006 to \$1.4 billion, with \$959.8 million in wealth management services and \$416.6 million in brokerage services. The 2006 increase is attributable to increased performance in the stock markets and newly developed business relationships.

EXPLANATION OF USE OF NON-GAAP FINANCIAL MEASURES

In addition to the results of operations presented in accordance with generally accepted accounting principles (GAAP), S&T management uses, and this annual report contains or references, certain non-GAAP financial measures, such as net interest income on a fully tax-equivalent basis and operating revenue. S&T believes these non-GAAP financial measures provide information useful to investors in understanding our underlying operational performance and our business and performance trends as they facilitate comparisons with the performance of others in the financial services industry. Although S&T believes that these non-GAAP financial measures enhance investors' understanding of S&T's business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP.

We believe the presentation of net interest income on a fully tax-equivalent basis ensures comparability of net interest income arising from both taxable and tax-exempt sources and is consistent with industry practice. Interest income per the consolidated statements of income is reconciled to net interest income adjusted to a fully tax-equivalent basis on page 29.

Edgar Filing: S&T BANCORP INC - Form 10-K

Operating revenue is the sum of net interest income and noninterest income less security gains. In order to understand the significance of net interest income to S&T business and operating results, S&T management believes it is appropriate to evaluate the significance of net interest income as a component of operating revenue.

PAGE 27

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued****RESULTS OF OPERATIONS****Year Ended December 31, 2006****NET INCOME**

Net income was \$53.3 million or \$2.06 per diluted earnings per share in 2006, an 8 percent decrease from the \$58.2 million or \$2.18 per diluted earnings per share in 2005. The decrease in earnings was primarily the result of a higher provision for loan losses due to the deterioration in the credit quality of three large commercial loan relationships, the \$0.9 million charge-down for properties previously acquired through foreclosure and other increases to noninterest expense. The return on average assets was 1.64 percent for 2006, as compared to 1.90 percent for 2005. The return on average equity was 15.37 percent for 2006 compared to 16.57 percent for 2005.

RETURN ON EQUITY AND ASSETS

The table below shows consolidated operating and capital ratios of S&T for each of the last three years:

| | Year Ended December 31 | | |
|--------------------------|------------------------|--------|--------|
| | 2006 | 2005 | 2004 |
| Return on average assets | 1.64% | 1.90% | 1.83% |
| Return on average equity | 15.37% | 16.57% | 16.07% |
| Dividend payout ratio | 56.34% | 50.38% | 51.70% |
| Equity to asset ratio | 10.16% | 11.03% | 11.68% |

NET INTEREST INCOME

On a fully tax-equivalent basis, net interest income increased \$1.0 million or 1 percent in 2006 compared to 2005. The net yield on interest earning assets decreased to 3.86 percent in 2006 as compared to 4.05 percent in 2005. The decrease in the net yield on earning assets is primarily attributable to the effect of rising short-term interest rates in combination with a flat and inverted yield curve during the period. S&T's balance sheet is liability sensitive, with funding costs rising faster than asset yields in today's interest rate environment.

In 2006, average loans increased \$217.3 million and average securities, other investments and federal funds sold decreased \$50.7 million. The yields on average loans increased by 80 basis points, and the yields on average securities increased 15 basis points. Overall funding costs increased 75 basis points.

Average interest-bearing deposits provided \$249.1 million of the funds for the growth in average earning assets, at a cost of 3.54 percent in 2006 as compared to 2.45 percent in 2005. The cost of repurchase agreements and other borrowed funds increased 157 basis points to 4.96 percent.

Edgar Filing: S&T BANCORP INC - Form 10-K

Negatively affecting net interest income was a \$13.8 million decrease in average net free funds during 2006 compared to 2005. Average net free funds are the excess of demand deposits, other noninterest-bearing liabilities and shareholders' equity over nonearning assets. The decrease is primarily due to a successful stock buy-back program in 2006, higher levels of cash and due from banks, defined benefit pension plan fundings and an increase in premises and equipment due to new branches and administrative facilities during 2006.

Net interest income represents the difference between the interest and fees earned on interest-earning assets and the interest paid on interest-bearing liabilities. Net interest income is affected by changes in the volume of interest-earning assets and interest-bearing liabilities and changes in interest yields and rates. Therefore, maintaining consistent spreads between earning assets and

PAGE 28

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

interest-bearing liabilities is very significant to our financial performance because net interest income comprised 76 percent of operating revenue, (net interest income plus noninterest income, excluding security gains) in 2006 and 78 percent in 2005. The level and mix of earning assets and funds are continually monitored by ALCO in order to mitigate the interest-rate sensitivity and liquidity risks of the balance sheet. A variety of ALCO strategies were successfully implemented, within prescribed ALCO risk parameters, to maintain an acceptable net interest margin given the challenges of the current interest rate environment.

Interest on loans to and obligations of state, municipalities and other public entities are not subject to federal income tax. As such, the stated (pre-tax) yield on these assets is lower than the yields on taxable assets of similar risk and maturity. In order to make the pre-tax income and resultant yields comparable to taxable loans and investments, a tax-equivalent adjustment was added to interest income in the tables below. This adjustment is calculated using the U.S. federal statutory corporate income tax rate of 35 percent for 2006, 2005 and 2004.

The following table reconciles interest income per the consolidated statements of income to net interest income adjusted to a fully tax-equivalent basis:

| | Year Ended December 31 | | |
|---|-------------------------------|-------------------|-------------------|
| | 2006 | 2005 | 2004 |
| <i>(dollars in thousands)</i> | | | |
| Interest income per consolidated statements of income | \$ 204,702 | \$ 172,122 | \$ 148,638 |
| Adjustment to fully tax-equivalent basis | 4,504 | 4,042 | 3,706 |
| Interest income adjusted to fully tax-equivalent basis | 209,206 | 176,164 | 152,344 |
| Interest expense | 91,584 | 59,514 | 40,890 |
| Net interest income adjusted to fully tax-equivalent basis | \$ 117,622 | \$ 116,650 | \$ 111,454 |

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued****Average Balance Sheet and Net Interest Income Analysis**

| | 2006 | | | December 31 2005 | | | 2004 | | |
|---|---------------------|-------------------|----------------|---------------------|-------------------|----------------|---------------------|-------------------|----------------|
| | Average Balance | Interest | Yield/ Rate | Average Balance | Interest | Yield/ Rate | Average Balance | Interest | Yield/ Rate |
| <i>(dollars in thousands)</i> | | | | | | | | | |
| ASSETS | | | | | | | | | |
| Loans ⁽¹⁾⁽²⁾ | \$ 2,588,175 | \$ 187,818 | 7.26% | \$ 2,370,851 | \$ 153,193 | 6.46% | \$ 2,225,314 | \$ 128,086 | 5.76% |
| Taxable investment securities | 362,307 | 16,374 | 4.52% | 413,967 | 18,638 | 4.50% | 479,944 | 20,669 | 4.31% |
| Tax-exempt investment securities ⁽²⁾ | 84,116 | 4,145 | 4.93% | 78,846 | 3,844 | 4.88% | 67,701 | 3,275 | 4.84% |
| Other investments | 12,676 | 771 | 6.09% | 16,126 | 395 | 2.45% | 19,013 | 295 | 1.55% |
| Federal funds sold | 1,890 | 98 | 5.20% | 2,750 | 94 | 3.42% | 1,050 | 19 | 1.81% |
| Total interest-earning assets ⁽³⁾ | 3,049,164 | 209,206 | 6.86% | 2,882,540 | 176,164 | 6.11% | 2,793,022 | 152,344 | 5.45% |
| Noninterest-earning assets: | | | | | | | | | |
| Cash and due from banks | 53,331 | | | 50,471 | | | 46,964 | | |
| Premises and equipment, net | 31,973 | | | 26,494 | | | 23,850 | | |
| Other assets | 162,866 | | | 149,305 | | | 142,249 | | |
| Less allowance for loan losses | (36,427) | | | (35,466) | | | (33,357) | | |
| Total | \$ 3,260,907 | | | \$ 3,073,344 | | | \$ 2,972,728 | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | | |
| NOW/Money market accounts | \$ 334,987 | \$ 3,796 | 1.13% | \$ 438,356 | \$ 3,833 | 0.87% | \$ 538,471 | \$ 3,264 | 0.61% |
| Savings deposits | 829,700 | 32,787 | 3.95% | 502,641 | 11,263 | 2.24% | 235,926 | 1,493 | 0.63% |
| Time deposits | 914,621 | 36,946 | 4.04% | 889,261 | 29,728 | 3.34% | 857,534 | 25,874 | 3.02% |
| Federal funds purchased | 21,560 | 1,109 | 5.14% | 21,829 | 727 | 3.33% | 25,392 | 371 | 1.46% |
| Securities sold under repurchase agreements | 92,984 | 4,063 | 4.37% | 110,577 | 3,218 | 2.91% | 139,253 | 1,547 | 1.11% |
| Short-term borrowings | 88,342 | 4,424 | 5.01% | 221,918 | 7,127 | 3.21% | 293,391 | 4,321 | 1.47% |
| Long-term borrowings | 154,276 | 7,988 | 5.18% | 78,419 | 3,618 | 4.61% | 103,900 | 4,020 | 3.87% |
| Subordinated debt | 6,986 | 471 | 6.74% | | | | | | |
| Total interest-bearing liabilities ⁽³⁾ | 2,443,456 | 91,584 | 3.75% | 2,263,001 | 59,514 | 2.63% | 2,193,867 | 40,890 | 1.86% |
| Noninterest-bearing liabilities: | | | | | | | | | |
| Demand deposits | 423,808 | | | 411,236 | | | 391,885 | | |
| Other | 46,732 | | | 47,570 | | | 48,725 | | |
| Shareholders' equity | 346,911 | | | 351,537 | | | 338,251 | | |
| Total | \$ 3,260,907 | | | \$ 3,073,344 | | | \$ 2,972,728 | | |
| Net interest income | | \$ 117,622 | | | \$ 116,650 | | | \$ 111,454 | |
| Net yield on interest-earning assets | | | 3.86% | | | 4.05% | | | 3.99% |

(1) For the purpose of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.

(2) Tax-exempt income is on a fully tax-equivalent basis, including the dividend-received deduction for equity securities, using the statutory federal corporate income tax rate of 35 percent for 2006, 2005 and 2004.

(3) Yields are calculated using historical cost basis.

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

The following tables set forth for the periods indicated a summary of the changes in interest earned and interest paid resulting from changes in volume and changes in rates:

| | 2006 Compared to 2005 Increase (Decrease) Due to ⁽¹⁾ | | | 2005 Compared to 2004 Increase (Decrease) Due to ⁽¹⁾ | | |
|---|--|-------------------|------------------|--|-------------------|-----------------|
| | Volume | Rate | Net | Volume | Rate | Net |
| <i>(dollars in thousands)</i> | | | | | | |
| Interest earned on: | | | | | | |
| Loans ⁽²⁾ | \$ 14,043 | \$ 20,583 | \$ 34,626 | \$ 8,377 | \$ 16,729 | \$ 25,106 |
| Taxable investment securities | (2,326) | 62 | (2,264) | (2,841) | 811 | (2,030) |
| Tax-exempt investment securities ⁽²⁾ | 257 | 43 | 300 | 539 | 30 | 569 |
| Other investments | (85) | 461 | 376 | (45) | 145 | 100 |
| Federal funds sold | (29) | 34 | 5 | 31 | 44 | 75 |
| Total interest-earning assets | 11,860 | 21,183 | \$ 33,043 | 6,061 | 17,759 | 23,820 |
| Interest paid on: | | | | | | |
| NOW/money market accounts | (904) | 867 | (37) | (607) | 1,176 | 569 |
| Savings deposits | 7,329 | 14,195 | 21,524 | 1,688 | 8,082 | 9,770 |
| Time deposits | 848 | 6,370 | 7,218 | 958 | 2,896 | 3,854 |
| Federal funds purchased | (9) | 390 | 381 | (52) | 408 | 356 |
| Securities sold under agreements to repurchase | (512) | 1,357 | 845 | (318) | 1,990 | 1,672 |
| Short-term borrowings | (4,290) | 1,587 | (2,703) | (1,053) | 3,859 | 2,806 |
| Long-term borrowings | 3,499 | 873 | 4,372 | (986) | 583 | (403) |
| Subordinated debt | 471 | | 471 | | | |
| Total interest-bearing liabilities | 6,432 | 25,639 | 32,071 | (370) | 18,994 | 18,624 |
| Change in net interest income | \$ 5,428 | \$ (4,456) | \$ 972 | \$ 6,431 | \$ (1,235) | \$ 5,196 |

(1) The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

(2) Tax-exempt income is on a fully tax-equivalent basis using the statutory federal corporate income tax rate of 35 percent for 2006, 2005 and 2004.

PROVISION FOR LOAN LOSSES

The provision for loan losses is an amount added to the allowance against which loan losses are charged. The provision for loan losses was \$9.4 million and \$5.0 million for 2006 and 2005, respectively. The provision is the result of management's assessment of credit quality statistics and other risk factors that would have an impact on probable losses in the loan portfolio, and the model used to determine the adequacy of the allowance for loan losses. A statistical model is used to assist in the determination of the adequacy of the allowance for loan losses. Changes in the risk ratings within allowance for loan loss model are consistent with the decline in asset quality, which includes a significant increase in net loan charge-offs and nonaccrual loans that occurred as a result of the aforementioned commercial loan relationships.

Credit quality is the most important factor in determining the amount of the allowance, and the resulting provision. Also affecting the amount of the allowance and resulting provision is loan growth and portfolio composition. Most of the loan growth in 2006 and 2005 is attributable to larger commercial loans. Net loan charge-offs totaled \$12.7 million for 2006 and \$1.7 million in 2005. The most significant charge-offs for 2006 were the aforementioned \$7.2 million construction company, \$2.7 million for a commercial real estate loan participation and \$1.5 million for a wholesale

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

distributor, all of which were previously considered in the analysis for the adequacy of the allowance for loan losses. Nonaccrual loans to total loans increased to 0.74 percent at December 31, 2006 as compared to 0.45 percent at December 31, 2005.

NONINTEREST INCOME

Noninterest income, excluding net security gains, increased \$2.5 million, or 8 percent in 2006 compared to 2005. Increases included \$0.8 million or 9 percent in service charges on deposit accounts, a \$0.9 million or 13 percent increase in wealth management fees, a \$1.0 million or 17 percent increase in insurance activities and a \$0.6 million or 8 percent increase in other revenue, offset by a \$0.8 million or 53 percent decrease in mortgage banking activities.

S&T recognized \$6.1 million of gains on the sale of securities in 2006. These gains were partially offset by \$0.6 million of realized losses taken for an-other-than-temporary impairment, in accordance with FSP 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments", on three equity investment securities. Security gains were primarily attributable to the sales of equity securities in order to maximize returns by taking advantage of market opportunities when presented. The equities portfolio is comprised primarily of bank holding company common stock.

The \$0.8 million increase in service charges on deposit accounts is primarily a result of management's continued effort to implement reasonable fees for services performed and to manage closely the collection of these fees, as well as to expand new cash management relationships. During 2006, fees for insufficient funds increased \$0.9 million as a result of product redesign. The \$0.9 million increase in wealth management fees were a result of new business development and increased performance in the stock market values of customer accounts during 2006. Insurance commissions increased \$1.0 million primarily as a result of stronger overall sales volume and the acquisition of Holsinger Insurance Agency during the first quarter of 2006. These areas were the focus of several strategic initiatives and product enhancements implemented in order to expand these sources of noninterest income. The \$0.8 million decrease in mortgage banking activities is primarily a result of lower origination volumes and a decline in the gain on sale recognized upon sale of these loans into the secondary markets reflective, of a general slow-down in the housing market. Other fee revenue increases of \$0.6 million reflect normal organization expansion and include increases of \$0.5 million in debit/credit card activity.

NONINTEREST EXPENSE

Noninterest expense increased \$6.8 million or 11 percent in 2006 compared to 2005. S&T's efficiency ratio, which measures noninterest expense as a percent of noninterest income, excluding security gains plus net interest income on a fully tax-equivalent basis, was 45 percent in 2006 and 42 percent in 2005.

Staff expense increased 8 percent or \$2.9 million in 2006. This increase is primarily attributable to the effects of normal year-end merit increases, the addition of 15 average full-time equivalent staff to implement new strategic initiatives and expanded retail facilities and the \$0.8 million effect of implementing Financial Accounting Standards Board Statement No. 123(R), "Share Based Payment". Also impacting staff expense in 2006 is a \$1.0 million incentive paid to all employees to provide transitioning from bank-wide stock option grants into a new performance-based incentive plan. No corporate-wide stock option grants, including grants to executive management and directors, were awarded in 2006, as compared to prior years. Average full-time equivalent staff was 801 in 2006 and 786 in 2005.

S&T's net periodic defined benefit plan cost is based primarily on three assumptions: the discount rate for plan liabilities, the expected return on plan assets and the rate of compensation increase. Net periodic pension expense of \$0.8 million and \$0.9 million, respectively was recorded for

S&T s

PAGE 32

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

defined benefit plan for 2006 and 2005. Net periodic pension expense is expected to approximate \$0.1 million for the year 2007, assuming no significant changes in plan assumptions.

Occupancy, equipment and data processing expense increased 7 percent or \$0.9 million as compared to 2005 due to several facility restructurings, which included the addition of new branches and administrative facilities. Other tax expense increased 10 percent or \$0.3 million as compared to 2005 primarily as a result of increases in Pennsylvania shares tax. Other expenses increased 25 percent or \$2.5 million in 2006 as compared to 2005 primarily due to \$1.0 million of write-downs of real estate previously acquired through foreclosure to current market values, an increase of \$0.6 million in the allowance for lending-related commitments, a \$0.3 million increase in legal expenses and \$0.4 million of revenue received in 2005 for a historical rehabilitation tax credit partnership.

FEDERAL INCOME TAXES

Federal income tax expense decreased \$2.8 million to \$21.5 million in 2006 as compared to 2005. This decrease is primarily attributable to a decrease in pre-tax income. The effective tax rate of 29 percent in 2006 and 2005 was below the 35 percent statutory tax rate due to the tax benefits resulting from tax-exempt interest, excludable dividend income and the tax benefits associated with Low Income Housing Tax Credit (LIHTC) and Federal Historic Tax Credit projects. S&T currently does not incur any alternative minimum tax.

RESULTS OF OPERATIONS

Year Ended December 31, 2005

NET INCOME

Net income was \$58.2 million or \$2.18 per diluted earnings per share in 2005, a 7 percent increase from the \$54.4 million or \$2.03 per diluted earnings per share in 2004. The increase in earnings was primarily the result of increases in net interest income and noninterest income offset by lower security gains and increased noninterest expense. The return on average assets was 1.90 percent for 2005, as compared to 1.83 percent for 2004. The return on average equity at 16.57 percent for 2005 compared to 16.07 percent for 2004.

NET INTEREST INCOME

On a fully tax-equivalent basis, net interest income increased \$5.2 million or 4.7 percent in 2005 compared to 2004. The net yield on interest-earning assets increased to 4.05 percent in 2005 as compared to 3.99 percent in 2004. The increase in net yield on interest earning assets is attributable to the effect of higher short-term interest rates on a balance sheet that was asset sensitive most of the year, growth in core deposits and reduced balance sheet leveraging activities as the risk reward for leveraging activities have been significantly reduced by a flattening yield curve.

Edgar Filing: S&T BANCORP INC - Form 10-K

In 2005, average loans increased \$145.6 million and average securities and federal funds sold decreased \$56.0 million. The yields on average loans increased by 70 basis points and the yields on average securities increased 22 basis points. Overall funding costs increased 66 basis points.

Average interest-bearing deposits provided \$198.3 million of the funds for the growth in average earning assets, at a cost of 2.45 percent in 2005 as compared to 1.88 percent in 2004. The cost of repurchase agreements and other borrowed funds increased 157 basis points to 3.39 percent.

Positively affecting net interest income was a \$20.3 million increase in average net free funds during 2005 compared to 2004. Average net free funds are the excess of demand deposits, other noninterest-bearing liabilities and shareholders' equity over nonearning assets. Most of this increase is due to the successful marketing of new demand accounts and corporate cash management services.

PAGE 33

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

PROVISION FOR LOAN LOSSES

The provision for loan losses was \$5.0 million and \$4.4 million for 2005 and 2004, respectively. Most of the loan growth in 2005 and 2004 is attributable to larger-sized commercial loans. Net loan charge-offs totaled \$1.7 million for 2005 and \$1.6 million in 2004. Included in the 2004 net charge-offs is a \$3.9 million recovery in the fourth quarter of 2004 of two previously charged-off commercial loans in the hotel and manufacturing industries that were considered in the determination of the allowance for loan losses. Nonaccrual loans to total loans increased to 0.45 percent at December 31, 2005 as compared to 0.28 percent at December 31, 2004.

NONINTEREST INCOME

Noninterest income, excluding net security gains, increased \$3.7 million or 13 percent in 2005 compared to 2004. Increases included \$0.2 million or 2 percent in service charges on deposit accounts, a \$0.8 million or 13 percent increase in wealth management fees, a \$0.2 million or 9 percent increase in letter of credit fees, a \$1.1 million or 25 percent increase in insurance activities, a \$0.1 million or 8 percent increase in mortgage banking activities and a \$1.3 million or 25 percent increase in other revenue.

Net security gains totaled \$5.0 million in 2005. S&T recognized \$5.3 million of gross gains on securities and gross losses of \$0.3 million on the sale of securities in 2005. Security gains were primarily attributable to the sales of equity securities in order to maximize returns by taking advantage of market opportunities when presented. The equities portfolio is comprised primarily of bank holding company common stock.

The increase in wealth management fees were a result of new business and general market improvements as well as a \$0.3 million increase in discount brokerage fees. Assets under management increased 5 percent in 2005 to \$1.2 billion as a result of new customers and general market improvements. Insurance commissions increased \$1.1 million primarily as a result of stronger overall sales volume and the acquisition of Bennett Associates Inc. and Cowher-Nehrig & Company during the first quarter of 2005. These areas were the focus of several strategic initiatives and product enhancements implemented in order to expand these sources of noninterest income. Other fee revenue increases of \$1.3 million reflect normal organization expansion and include increases of \$0.5 million in debit/credit card activity, \$0.5 million of commercial loan swap fees and \$0.2 million of gains on the sale of real estate owned acquired through foreclosure.

NONINTEREST EXPENSE

Noninterest expense increased \$2.5 million or 4 percent in 2005 compared to 2004. S&T's efficiency ratio, which measures noninterest expense as a percent of noninterest income, excluding security gains plus net interest income on a fully tax-equivalent basis, was 42 percent in 2005 and 43 percent in 2004.

Staff expense increased 6 percent or \$1.9 million in 2005. This increase is primarily attributable to the effects of year-end merit increases and increased staffing levels required to implement new initiatives, offset by lower medical plan costs in 2005. Average full-time equivalent staff was 786 in 2005 and 774 in 2004.

S&T's net periodic defined benefit plan cost is based primarily on three assumptions: the discount rate for plan liabilities, the expected return on plan assets and the rate of compensation increase. Net periodic pension expense of \$0.9 million was recorded for S&T's defined benefit plan for

2005 and 2004.

Occupancy and equipment expense increased 14 percent or \$1.0 million as compared to 2004 as a result of a renegotiated and shorter lease term for an existing headquarter facility resulting in

PAGE 34

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

acceleration of depreciation terms for leasehold improvements. Data processing costs increased 8 percent or \$0.3 million in 2005 as compared to 2004. This increase is primarily attributable to increased organizational growth related to increased business activity, primarily in the commercial lending and credit administration areas. Other expenses decreased 6 percent or \$0.6 million in 2005 as compared to 2004 primarily due to a \$0.4 million reduction in the losses on low income housing and historical rehabilitation tax credit projects, a \$0.1 million decrease to the allowance for lending-related commitments and a \$0.1 million refund resulting from a sales/use tax review initiative.

FEDERAL INCOME TAXES

Federal income tax expense increased \$1.3 million to \$24.3 million in 2005 as compared to 2004. This increase is primarily attributable to a higher level of taxable income. The effective tax rate of 29 percent in 2005 and 30 percent in 2004 was below the 35 percent statutory tax rate due to the tax benefits resulting from tax-exempt interest, excludable dividend income and the tax benefits associated with Low Income Housing Tax Credit (LIHTC) and Federal Historic Tax Credit projects. S&T currently does not incur any alternative minimum tax.

LIQUIDITY AND CAPITAL RESOURCES

Shareholders' equity decreased \$13.4 million at December 31, 2006 compared to December 31, 2005. The primary source of equity growth is earnings retention. Capital growth is a function of net income less dividends paid to shareholders and treasury stock activities.

Net income was \$53.3 million and dividends paid to shareholders were \$30.0 million for 2006. S&T paid 56 percent of 2006 net income in dividends, equating to an annual dividend rate of \$1.17 per share. Also affecting capital was a decrease of \$2.1 million in unrealized gains on securities available for sale, net of tax, which is included in other comprehensive income. Also affecting capital was a decrease of \$3.0 million upon adoption of Financial Accounting Standards Board Statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Post Retirement Plans, which is included in other comprehensive income, net of tax and the effects of stock buybacks.

During 2006, S&T repurchased 1,031,700 shares of its common stock at an average price of \$34.19 per share. The impact of the repurchased shares is \$0.02 increase to diluted earnings per share. The S&T Board of Directors previously authorized a stock buyback program for 2006 of up to one million shares, or approximately 4 percent of shares outstanding. During 2006, S&T repurchased 999,000 shares under this program at an average cost of \$34.20 per share. On October 16, 2006, the S&T Board of Directors authorized a new stock buyback program until September 30, 2007 of an additional one million shares with 32,700 shares repurchased under this plan during the fourth quarter of 2006 at an average cost of \$33.63 per share. S&T reissued 122,244 shares during 2006 primarily through the exercise of employee stock options. See schedule on page 15 for the 2006 share repurchase activity.

On September 21, 2006, S&T Bank issued \$25.0 million of junior subordinated debt through a pooled transaction at an initial fixed rate of 6.78%. On September 15, 2011 and quarterly thereafter, S&T bank shall have the option to redeem the subordinated debt, subject to a 30 day written notice and prior approval by the FDIC. If S&T Bank chooses not to exercise the option for early redemption on September 15, 2011 or subsequent quarters, the subordinated debt will convert to a variable rate of 3-month LIBOR plus 160 basis points. The subordinated debt qualifies as Tier 2 capital under regulatory guidelines and will mature on December 15, 2036.

S&T continues to maintain a strong capital position with a leverage ratio of 8.8 percent as compared to the 2006 minimum regulatory guideline of 3 percent. S&T's risk-based capital Tier 1 and Total ratios were 9.7 percent and 11.9 percent, respectively, at December 31, 2006, which places S&T well above the Federal Reserve Board's risk-based capital guidelines of 4 percent and 8 percent for

Table of Contents**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued**

Tier 1 and Total capital. Included in the total ratio is 45 percent of the pretax unrealized holding gains on available for sale equity securities as prescribed by banking regulations effective October 1, 1998. In addition, management believes that S&T has the ability to raise additional capital if necessary.

During 2003, S&T filed a shelf registration statement on Form S-3 under the Securities Act of 1933 with the SEC for the issuance of up to \$150.0 million of a variety of securities including, debt and capital securities, preferred and common stock and warrants. S&T may use the proceeds from the sale of any securities for general corporate purposes, which could include investments at the holding company level, investing in, or extending credit to, its subsidiaries, possible acquisitions and stock repurchases. As of December 31, 2006, S&T had not issued any securities pursuant to the shelf registration statement.

In April 1993, shareholders approved the S&T Incentive Stock Plan (Stock Plan) authorizing the issuance of a maximum of 1.2 million shares of S&T's common stock to assist in attracting and retaining employees of outstanding ability and to align their interests with those of the shareholders of S&T. On October 17, 1994, the Stock Plan was amended to include outside directors. On April 21, 1997, shareholders approved an amendment to the Stock Plan increasing the number of authorized shares to 3.2 million. As of December 31, 2002, 3,180,822 nonstatutory stock options and 35,600 restricted stock awards had been granted to key employees and outside directors under the Stock Plan; 906,962 of these awards are currently exercisable. In April 2003, shareholders approved the 2003 S&T Incentive Stock Plan (2003 Stock Plan) authorizing the issuance of 1.5 million shares, subject to capital adjustments as provided in the 2003 Stock Plan. The purpose of the 2003 Stock Plan is to promote the long-term interests of S&T and its shareholders by attracting and retaining directors, officers and key employees. S&T believes that directors, officers and employees who own shares of its common stock will have a closer identification with S&T and a greater motivation to work for S&T's success, because, as shareholders, they will participate in S&T's growth and earnings. As of December 31, 2006, 937,500 nonstatutory stock options had been granted under the 2003 Stock Plan to employees and directors; 642,750 of these awards are currently exercisable. On December 19, 2005, S&T also granted 206,900 cash appreciation rights under the 2005 Cash Appreciation Rights Plan to employees. None of these awards are currently exercisable. No corporate-wide stock option grants, including grants to executive management and directors, were awarded in 2006.

S&T has various financial obligations, including contractual obligations and commitments that may require future cash payments. The following table presents as of December 31, 2006, significant fixed and determinable contractual obligations to third parties by payment date:

| | Payments Due In | | | | Total |
|--|-----------------------|--------------------------|---------------------------|--------------------|---------------------|
| | Less than One Year | One to Three Years | Three to Five Years | Over Five Years | |
| <i>(dollars in thousands)</i> | | | | | |
| Deposits without a stated maturity ⁽¹⁾ | \$ 1,644,094 | \$ | \$ | \$ | \$ 1,644,094 |
| Time deposits ⁽¹⁾ | 659,530 | 216,789 | 35,557 | 9,337 | 921,213 |
| Federal funds purchased and securities sold under repurchase agreements ⁽¹⁾ | 133,021 | | | | 133,021 |
| Short-term borrowings ⁽¹⁾ | 55,000 | | | | 55,000 |
| Long-term borrowings ⁽¹⁾ | 20,921 | 135,394 | 6,324 | 9,303 | 171,942 |
| Junior subordinated debt securities ⁽¹⁾ | | | | 25,000 | 25,000 |
| Operating leases | 1,089 | 2,079 | 1,996 | 15,004 | 20,168 |
| Purchase obligations | 3,000 | 6,000 | 2,750 | | 11,750 |
| Total | \$ 2,516,655 | \$ 360,262 | \$ 46,627 | \$ 58,644 | \$ 2,982,188 |

(1) Excludes interest

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

Operating lease obligations represent short-term lease arrangements as described in Note F to the consolidated financial statements. Purchase obligations represent obligations under agreement with Metavante, S&T's third party data processing servicer, for operational services outsourced. The Metavante obligation has a buyout provision of 40 percent of the remaining payments under the original term of the contract.

In the normal course of business, S&T commits to extend credit and issue standby letters of credit. These obligations are not recorded in our financial statements. Loan commitments and standby letters of credit are subject to S&T's normal credit underwriting policies and procedures and generally require collateral based upon management's evaluation of each customer's financial condition and ability to satisfy completely the terms of the agreement and are renewed on an annual basis. Our exposure to credit loss in the event the customer does not satisfy the terms of the agreement equals the notional amount of the obligation less the value of any collateral. Unfunded commercial loan commitments totaled \$686,204,000 and \$635,809,000 at December 31, 2006 and 2005, respectively. Unfunded other loan commitments totaled \$157,863,000 and \$144,694,000 at December 31, 2006 and 2005, respectively; and obligations under standby letters of credit totaled \$220,494,000 and \$206,249,000 at December 31, 2006 and 2005, respectively.

REGULATORY MATTERS

S&T and S&T Bank are subject to periodic examinations by one or more of the various regulatory agencies. During 2006, an examination of S&T Bank was conducted by the Federal Deposit Insurance Corporation (FDIC) and a financial holding company inspection was conducted by the Federal Reserve Bank of Cleveland (Federal Reserve). The examination by the FDIC included, but was not limited to, procedures designed to review lending practices, credit quality, liquidity, operations and capital adequacy of S&T Bank and its subsidiaries. The examination by the Federal Reserve included, but was not limited to, procedures designed to review board of director and related committee meetings minutes, financial statements, corporate policies and intercompany transactions of S&T and its subsidiaries. No comments were received from the FDIC or Federal Reserve that would have a material effect on S&T's liquidity, capital resources or operations. S&T's current capital position and results of regulatory examination allow it to pay the lowest possible rate for FDIC deposit insurance.

CRITICAL ACCOUNTING POLICIES AND JUDGMENTS

We have established various accounting policies that govern the application of accounting principles generally accepted in the United States in the preparation of its consolidated financial statements. The most significant of these policies are described in Note A Accounting Policies. Certain of these policies require numerous estimates and strategic or economic assumptions that may prove inaccurate or subject to variations and may significantly affect S&T's reported results and financial position for the period or in future periods. Changes in underlying factors, assumptions or estimates in any of these areas could have a material impact on S&T's future financial condition and results of operations.

Securities

Securities are reported at cost adjusted for premiums and discounts and are recognized in interest income using the interest method over the period to maturity. Declines in market value of individual securities below their amortized cost, and that are other-than-temporary, will be written down to current market value and included in earnings as realized losses. Management systematically evaluates securities for other-than-temporary declines in market value on a quarterly basis. If the financial markets experience deterioration, additional charges to

income could occur in future periods.

PAGE 37

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

Allowance for Loan Losses

Determination of an adequate allowance for loan losses is inherently subjective, as it requires estimations of occurrence of future events as well as timing of such events.

The allowance for loan losses is increased by charges to income and decreased by charge-offs (net of recoveries). S&T's periodic evaluation of the adequacy of the allowance for loan losses is determined by management through evaluation of the loss exposure on individual impaired, nonperforming and delinquent and high-dollar loans; review of risk conditions and business trends; historical loss experience; and growth and composition of the loan portfolio, as well as other relevant factors.

A quantitative analysis is utilized to support the adequacy of the allowance for loan losses. This analysis includes review of the historical charge-offs that have occurrence within the credit's economic life cycle. Management also assesses qualitative factors such as portfolio credit trends, unemployment trends, vacancy trends, loan growth and variable interest rate factors.

Significant to this analysis is the shift in loan portfolio composition to an increased mix of commercial loans. These loans are generally larger in size, and, due to our continuing growth, many are unsecured or new loan relationships. Management relies on its risk-rating process to monitor trends that may be occurring relative to commercial loans to assess potential weaknesses within the credit. Current risk factors and trends in risk ratings are considered in the determination and allocation of the allowance for loan losses. During 2006, the risk-rating profile of the portfolio remained relatively stable.

The allowance for loan losses at December 31, 2006 includes \$28.5 million or 86 percent of the allowance allocated to commercial and industrial and commercial real estate loans. The ability for customers to repay commercial loans is more dependent upon the success of their business, continuing income and general economic conditions. Accordingly, the risk of loss is higher on such loans than on residential real estate loans, which generally incur lower losses in the event of foreclosure as the collateral value typically exceeds the loan amounts.

Goodwill and Other Intangible Assets

S&T has \$2.9 million of core deposit intangible assets subject to amortization and \$49.9 million in goodwill, which is not subject to periodic amortization. S&T determined the amount of identifiable intangible assets based upon an independent core deposit analysis and insurance contract analysis. An annual evaluation of identifiable intangible assets for impairment is performed by S&T. S&T concluded that the recorded value of identifiable intangible assets was not impaired as a result of the evaluation as of December 31, 2006.

Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. S&T's goodwill relates to value inherent in the banking business and the value is dependent upon S&T's ability to provide quality, cost-effective services in the face of free competition from other market participants on a regional basis. This ability relies upon continuing investments in processing systems, the development of value-added service features and the ease of use of S&T's services. As such, goodwill value is supported ultimately by revenue that is driven by the volume of business transacted. A decline in earnings as a result of a lack of growth or the inability to deliver cost-effective services over sustained periods can lead to impairment of goodwill, which could adversely impact earnings in future periods. An annual evaluation of goodwill for impairment is performed by S&T. The market value of S&T and the implied market value of goodwill at the respective reporting unit level are estimated using industry comparable information. S&T concluded that the recorded value of goodwill was not impaired as a result of the evaluation as of October 1, 2006.

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

INFLATION

Management is aware of the significant effect inflation has on interest rates and can have on financial performance. S&T's ability to cope with this is best determined by analyzing its capability to respond to changing interest rates and its ability to manage noninterest income and expense. S&T monitors its mix of interest-rate sensitive assets and liabilities through ALCO in order to reduce the impact of inflation on net interest income. Management also controls the effects of inflation by reviewing the prices of its products and services, by introducing new products and services and by controlling overhead expenses.

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Annual Report on Form 10-K contains or incorporates statements that S&T believes are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements generally relate to S&T's financial condition, results of operations, plans, objectives, future performance or business. They usually can be identified by the use of forward-looking language such as will likely result, may, are expected to, is anticipated, estimate, forecast, projected, intends to or other similar words. You should not place undue reliance on the statements, as they are subject to risks and uncertainties, including but not limited to those described in this Form 10-K or the documents incorporated by reference. When considering these forward-looking statements, you should keep in mind these risks and uncertainties, as well as any cautionary statements we may make. Moreover, you should treat these statements as speaking only as of the date they are made and based only on information then actually known to us. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

These forward-looking statements are based on current expectations, estimates and projections about S&T's business, management's beliefs and assumptions made by management. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions (Future Factors), which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in these forward-looking statements.

Future Factors include:

- changes in interest rates, spreads on earning assets and interest-bearing liabilities, and interest rate sensitivity;
- credit losses;
- sources of liquidity;
- legislation affecting the financial services industry as a whole, and/or S&T and its subsidiaries individually or collectively;
- regulatory supervision and oversight, including required capital levels;
- increasing price and product/service competition by competitors, including new entrants;
- rapid technological developments and changes;
- the ability to continue to introduce competitive new products and services on a timely, cost-effective basis;
- the mix of products/services;
- containing costs and expenses;
- governmental and public policy changes, including environmental regulations;
- reliance on large customers;

Edgar Filing: S&T BANCORP INC - Form 10-K

technological, implementation and cost/financial risks in large, multi-year contracts;
the outcome of pending and future litigation and governmental proceedings;
continued availability of financing;

PAGE 39

Table of Contents

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

financial resources in the amounts, at the times and on the terms required to support our future businesses; and general economic or business conditions, either nationally or regionally, may be less favorable than expected, resulting in among other things, a reduced demand for credit and other services.

These are representative of the Future Factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions and growth rates, general economic conditions, including interest rate and currency exchange rate fluctuations, and other Future Factors.

LIQUIDITY AND INTEREST RATE SENSITIVITY

Liquidity refers to the ability to satisfy the financial needs of depositors who want to withdraw funds, or of borrowers needing access to funds to meet their credit needs. Interest-rate sensitivity management seeks to avoid fluctuating net interest margins and to enhance net interest income through periods of changing interest rates. The ALCO is responsible for establishing and monitoring the liquidity and interest rate sensitivity guidelines, procedures and policies.

The principal sources of asset liquidity are cash and due from banks, interest-earning deposits with banks, federal funds, investment securities that mature in one year or less and securities available for sale. At December 31, 2006, the total of such assets was approximately \$502.6 million or 15 percent of consolidated assets. While much more difficult to quantify, liability liquidity is further enhanced by a stable core deposit base, access to credit lines at other financial institutions and S&T's ability to renew maturing deposits. Certificates of deposit in denominations of \$100,000 or more represented 10 percent of deposits at December 31, 2006 and were outstanding primarily to local customers. S&T's ability to attract deposits and borrow funds depends primarily on continued rate competitiveness, profitability, capitalization and overall financial condition.

Beyond the issue of having sufficient sources to fund unexpected credit demands or deposit withdrawals, liquidity management also is an important factor in monitoring and managing interest-rate sensitivity issues through ALCO. Through forecast and simulation models, ALCO is also able to project future funding needs and develop strategies for acquiring funds at a reasonable cost. ALCO uses a variety of measurements to monitor the liquidity position of S&T. These include liquidity gap, liquidity forecast, net loans and standby letters of credit to assets, net loans to deposits and net non-core funding dependence ratio.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Because the assets and liabilities of S&T are primarily monetary in nature, the presentation and analysis of cash flows in formats prescribed by accounting principles generally accepted in the United States are less meaningful for managing bank liquidity than for non-financial companies. Funds are typically provided from current earnings, maturity and sales of securities available for sale, loan repayments, deposits and borrowings. The primary uses of funds include new loans, repayment of borrowings, the purchase of securities and dividends to shareholders. The level and mix of sources and uses of funds are constantly monitored and adjusted by ALCO in order to maintain credit, liquidity and interest-rate risks within prescribed policy guidelines while maximizing earnings.

ALCO monitors and manages interest-rate sensitivity through gap, rate shock and rate ramp analyses, economic value of equity (EVE) and simulations in order to avoid unacceptable earnings fluctuations due to interest rate changes. Interest rate sensitivity analyses are highly

Edgar Filing: S&T BANCORP INC - Form 10-K

dependent on assumptions, which have been developed based upon past experience and the expected behavior of customers under various rate scenarios. The assumptions include principal prepayments for fixed rate

PAGE 40

Table of Contents**Item 7(A). QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK continued**

loans, mortgage-backed securities and collateralized mortgage obligations (CMOs), and classifying the demand, savings and money market balances by degree of interest-rate sensitivity.

The gap and cumulative gap represents the net position of assets and liabilities subject to repricing in specified time periods, as measured by a ratio of rate sensitive assets to rate sensitive liabilities. The gap analysis below incorporates a flat rate scenario, and the following significant assumptions:

| | |
|--|---------|
| Monthly loan prepayments above contractual requirements | |
| 3 year ARM Commercial Real Estate | 1.50% |
| 5 year ARM Commercial Real Estate | 1.75% |
| Fixed Rate Commercial Real Estate | 1.75% |
| Residential Real Estate | 1.50% |
| Fixed Rate Home Equity | 1.50% |
| Other Installment Loans | 2.25% |
| Deposit behavioral pattern/decay rate assumptions | |
| NOW and Savings Year #1 | 25.00% |
| NOW and Savings Year #2 | 25.00% |
| NOW and Savings beyond Year #2 | 50.00% |
| Green Plan Savings 1-6 Months | 100.00% |
| Money Market 1-6 Months | 100.00% |
| S&T has not historically experienced significant fluctuations in demand deposit balances during periods of interest rate fluctuations. | NA |

Table of Contents**Item 7(A). QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK** continued**Interest Rate Sensitivity****December 31, 2006**

| GAP <i>(dollars in thousands)</i> | 1-6 Months | 7-12 Months | 13-24 Months | >2 Years |
|---|---------------------|---------------------|---------------------|--------------------|
| Repricing Assets: | | | | |
| Cash/due from banks | \$ | \$ | \$ | \$ 59,980 |
| Securities available for sale | 48,881 | 32,289 | 73,855 | 277,020 |
| Other investments | 10,562 | | | |
| Net loans | 1,307,954 | 222,911 | 373,237 | 728,969 |
| Other assets | | | | 202,885 |
| Total | 1,367,397 | 255,200 | 447,092 | 1,268,854 |
| Repricing Liabilities: | | | | |
| Demand | | | | 448,453 |
| NOW | 18,821 | 18,821 | 37,642 | 75,284 |
| Money market | 163,105 | | | |
| Savings/clubs | 770,116 | 15,979 | 31,958 | 63,914 |
| Certificates | 443,555 | 215,979 | 161,685 | 99,994 |
| Repos & short-term borrowings | 188,021 | | | |
| Long-term borrowings | 3,555 | 20,466 | 50,965 | 121,955 |
| Other liabilities/equity | | | | 388,275 |
| Total | 1,587,173 | 271,245 | 282,250 | 1,197,875 |
| GAP | \$ (219,776) | \$ (16,045) | \$ 164,842 | \$ 70,979 |
| Cumulative GAP | \$ (219,776) | \$ (235,821) | \$ (70,979) | \$ |

| Rate Sensitive Assets/Rate Sensitive Liabilities | December 31, 2006 | December 31, 2005 |
|---|--------------------------|--------------------------|
| Cumulative 6 months | 0.86 | 0.96 |
| Cumulative 12 months | 0.87 | 0.96 |

S&T's one-year gap position at December 31, 2006 indicates a liability sensitive position. This means that more liabilities than assets will reprice during the measured time frames. The implications of a liability sensitive position will differ depending upon the change in market interest rates. For example, with a liability sensitive position in a declining interest rate environment, more liabilities than assets will decrease in rate. This situation could result in an increase to our interest rate spreads, net interest income and operating spreads. Conversely, with a liability sensitive position in a rising interest rate environment, more liabilities than assets will increase in rates. This situation could result in a decrease to our interest rate spreads, net interest income and operating spreads.

S&T has become more liability sensitive since December 2005 mainly as a result of an inverted yield curve. An inverted yield curve occurs when short-term interest rates are higher than long-term interest rates. When the yield curve is inverted customers tend to prefer short-term deposits and long-term loans, both of which make the bank more liability sensitive.

In addition to the gap analysis, S&T performs rate shock and rate ramp analyses on a static balance sheet to estimate the effect that a +/-100, +/-200 and +/-300 basis point instantaneous and gradual parallel shift in the yield curve would have on 12 months of pretax net interest income. The rate shocks incorporate assumptions regarding the level of interest rate changes on non-maturity deposit products (savings, money market, NOW and demand deposits) and changes in the

Table of Contents**Item 7(A). QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK continued**

prepayment behavior of fixed rate loans and securities with optionality. Inclusion of these assumptions makes rate shock and rate ramp analyses more useful than gap analysis alone. S&T's policy is to limit the change in net interest income over a one-year horizon to -20% given changes in rates using shocks or rate ramps up to +/-300 basis points. Although +/-100 and +/-200 basis point changes for the rate shock and rate ramp analyses are not policy guidelines, these analyses are performed to ensure directional consistency of the +/-300 basis point analysis. The December 2006 results reflect a .14% increase and -5.96% decrease to net interest income in the -300 and +300 basis point rate shock analysis respectively.

The table below shows the pretax net interest income impact of the +/-300 rate shock analyses.

| Change in Pretax Net Interest Income (dollars in millions) | Immediate Change in Rates | |
|---|---------------------------|----------|
| | +300 bps | -300 bps |
| December 31, 2006 | \$ (6.8) | \$ 0.0 |
| December 31, 2005 | \$ (1.0) | \$ (5.9) |

The results in the -300 basis point shock scenario are not consistent with a liability sensitive gap position, which typically would indicate an increase in net interest income. This is primarily due to: (1) rates on regular savings, NOW and money market accounts have lagged as short rates have increased and cannot be decreased to any great extent should rates go down, and (2) loan refinance activity will be considerable in rates down. When comparing December 2006 to December 2005 there was an improvement to net interest income in the -300 basis point rate shock scenario. This improvement can be attributed to three main reasons: (1) strong growth in savings and short term certificate of deposit balances; (2) fixed rate loan growth; and (3) implementing a strategy to mitigate the rates down risk on the balance sheet through structured borrowings.

Consistent with a liability sensitive gap position, the +300 rate shock results show pretax net interest income decreasing in an increasing interest rate environment. The pretax net interest income decline in the +300 basis point results from December 2005 is primarily due to strong growth in short term deposits and an increase in fixed rate loans.

In order to monitor interest rate risk beyond the one-year time horizon of shocks and rate ramps, S&T also performs economic value of equity (EVE) analysis. EVE represents the present value of all asset cash flows minus the present value of all liability cash flows. As with rate shock analysis, EVE incorporates management assumptions regarding prepayment behavior of fixed rate loans and securities with optionality and core deposit behavior. S&T's policy is to limit the change in EVE to -35% given changes in rates up to +/-300 basis points. The December 2006 results reflect a -9.02% and -8.75% decrease to EVE given a -300 and +300 basis point change in interest rates respectively.

Table of Contents

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Consolidated Financial Statements

| | |
|---|----|
| <u>Consolidated Balance Sheets</u> | 45 |
| <u>Consolidated Statements of Income</u> | 46 |
| <u>Consolidated Statements of Changes in Shareholders' Equity</u> | 47 |
| <u>Consolidated Statements of Cash Flows</u> | 48 |
| <u>Notes to Consolidated Financial Statements</u> | 49 |
| <u>Report of Management</u> | 76 |
| <u>Report of Ernst & Young LLP, Independent Registered Public Accounting Firm on Effectiveness of Internal Control Over Financial Reporting</u> | 77 |
| <u>Report of Ernst & Young LLP, Independent Registered Public Accounting Firm on Consolidated Financial Statements</u> | 78 |

Table of Contents**CONSOLIDATED BALANCE SHEETS****S&T Bancorp, Inc. and Subsidiaries**

| December 31 | 2006 | 2005 |
|---|---------------------|---------------------|
| <i>(dollars in thousands, except share and per share data)</i> | | |
| ASSETS | | |
| Cash and due from banks | \$ 59,980 | \$ 56,189 |
| Securities available for sale | 432,045 | 481,257 |
| Other investments | 10,562 | 13,318 |
| Loans held for sale | 826 | 1,580 |
| Portfolio loans, net of allowance for loan losses of \$33,220 in 2006 and \$36,572 in 2005 | 2,632,245 | 2,453,354 |
| Premises and equipment, net | 35,700 | 29,123 |
| Goodwill | 49,955 | 49,073 |
| Other intangibles, net | 4,985 | 5,478 |
| Bank owned life insurance | 34,251 | 33,107 |
| Other assets | 77,994 | 72,500 |
| Total Assets | \$ 3,338,543 | \$ 3,194,979 |
| LIABILITIES | | |
| Deposits: | | |
| Noninterest-bearing demand | \$ 448,453 | \$ 435,672 |
| Interest-bearing demand | 150,568 | 155,191 |
| Money market | 163,105 | 242,228 |
| Savings | 881,967 | 652,685 |
| Time deposits | 921,213 | 933,108 |
| Total Deposits | 2,565,306 | 2,418,884 |
| Securities sold under repurchase agreements and federal funds purchased | 133,021 | 137,829 |
| Short-term borrowings | 55,000 | 150,000 |
| Long-term borrowings | 171,941 | 83,776 |
| Junior subordinated debt securities | 25,000 | |
| Other liabilities | 49,224 | 52,069 |
| Total Liabilities | 2,999,492 | 2,842,558 |
| SHAREHOLDERS EQUITY | | |
| Preferred stock, without par value, 10,000,000 shares authorized and none outstanding | | |
| Common stock (\$2.50 par value) Authorized 50,000,000 shares in 2006 and 2005 Issued 29,714,038 shares in 2006 and 2005 | 74,285 | 74,285 |
| Additional paid-in capital | 26,698 | 26,120 |
| Retained earnings | 349,447 | 326,158 |
| Accumulated other comprehensive income | 4,014 | 9,172 |
| Treasury stock (4,352,764 shares in 2006 and 3,443,308 shares in 2005, at cost) | (115,393) | (83,314) |
| Total Shareholders Equity | 339,051 | 352,421 |
| Total Liabilities and Shareholders Equity | \$ 3,338,543 | \$ 3,194,979 |

See Notes to Consolidated Financial Statements

Table of Contents**CONSOLIDATED STATEMENTS OF INCOME****S&T Bancorp, Inc. and Subsidiaries**

| Year Ended December 31 <i>(dollars in thousands, except per share data)</i> | 2006 | 2005 | 2004 |
|---|------------------|------------------|------------------|
| INTEREST INCOME | | | |
| Loans, including fees | \$ 185,544 | \$ 151,328 | \$ 126,337 |
| Deposits with banks and federal funds sold | 101 | 95 | 20 |
| Investment Securities: | | | |
| Taxable | 14,293 | 15,990 | 18,003 |
| Tax-exempt | 2,694 | 2,499 | 2,129 |
| Dividends | 2,070 | 2,210 | 2,149 |
| Total Interest Income | 204,702 | 172,122 | 148,638 |
| INTEREST EXPENSE | | | |
| Deposits | 73,529 | 44,824 | 30,632 |
| Securities sold under repurchase agreements and federal funds purchased | 5,171 | 3,945 | 1,917 |
| Short-term borrowings | 4,424 | 7,127 | 4,321 |
| Long-term borrowings and capital securities | 8,460 | 3,618 | 4,020 |
| Total Interest Expense | 91,584 | 59,514 | 40,890 |
| NET INTEREST INCOME | 113,118 | 112,608 | 107,748 |
| Provision for loan losses | 9,380 | 5,000 | 4,400 |
| Net Interest Income After Provision for Loan Losses | 103,738 | 107,608 | 103,348 |
| NONINTEREST INCOME | | | |
| Security gains, net | 5,481 | 5,008 | 5,344 |
| Service charges on deposit accounts | 10,412 | 9,587 | 9,383 |
| Wealth management fees | 7,862 | 6,977 | 6,201 |
| Letter of credit fees | 2,284 | 2,208 | 2,022 |
| Insurance agency fees | 6,637 | 5,685 | 4,558 |
| Mortgage banking | 703 | 1,497 | 1,391 |
| Other | 7,011 | 6,424 | 5,502 |
| Total Noninterest Income | 40,390 | 37,386 | 34,401 |
| NONINTEREST EXPENSE | | | |
| Salaries and employee benefits | 37,601 | 34,715 | 32,845 |
| Occupancy, net | 5,101 | 4,816 | 4,166 |
| Furniture and equipment | 3,297 | 3,251 | 2,916 |
| Other taxes | 2,973 | 2,698 | 2,609 |
| Data processing | 4,852 | 4,290 | 3,966 |
| Marketing | 2,478 | 2,326 | 2,399 |
| Amortization of intangibles | 325 | 214 | 347 |
| FDIC assessment | 302 | 293 | 289 |
| Other | 12,350 | 9,861 | 10,853 |
| Total Noninterest Expense | 69,279 | 62,464 | 60,390 |
| Income Before Taxes | 74,849 | 82,530 | 77,359 |
| Applicable Income Taxes | 21,513 | 24,287 | 23,001 |
| Net Income | \$ 53,336 | \$ 58,243 | \$ 54,358 |
| Earnings per common share Basic | \$ 2.07 | \$ 2.21 | \$ 2.05 |
| Earnings per common share Diluted | 2.06 | 2.18 | 2.03 |
| Dividends declared per common share | 1.17 | 1.13 | 1.07 |
| See Notes to Consolidated Financial Statements | | | |

Table of Contents**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY****S&T Bancorp, Inc. and Subsidiaries**

| | Comprehensive Income | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income | Treasury Stock | Total |
|---|-------------------------|-----------------|----------------------------------|----------------------|---|-------------------|------------|
| <i>(dollars in thousands, except per share data)</i> | | | | | | | |
| Balance at December 31, 2003 | | \$ 74,285 | \$ 21,939 | \$ 271,699 | \$ 27,185 | \$ (62,390) | \$ 332,718 |
| Net income for 2004 | \$54,358 | | | 54,358 | | | 54,358 |
| Other comprehensive income, net of tax expense of \$2,209: | | | | | | | |
| Unrealized losses on securities of \$(2,791) net of reclassification adjustment for gains included in net income of \$3,519 | (6,310) | | | | (6,310) | | (6,310) |
| Comprehensive Income | \$48,048 | | | | | | |
| Cash dividends declared (\$1.07 per share) | | | | (28,367) | | | (28,367) |
| Treasury stock acquired (542,600 shares) | | | | | | (15,970) | (15,970) |
| Treasury stock issued for stock options exercised (490,584 shares) | | | (210) | | | 10,560 | 10,350 |
| Recognition of restricted stock compensation expense | | | 252 | | | | 252 |
| Tax benefit from nonstatutory stock options exercised | | | 2,098 | | | | 2,098 |
| Balance at December 31, 2004 | | \$ 74,285 | \$ 24,079 | \$ 297,690 | \$ 20,875 | \$ (67,800) | \$ 349,129 |
| Net income for 2005 | \$58,243 | | | 58,243 | | | 58,243 |
| Other comprehensive income, net of tax expense of \$4,096: | | | | | | | |
| Unrealized losses on securities of \$(8,448) net of reclassification adjustment for gains included in net income of \$3,255 | (11,703) | | | | (11,703) | | (11,703) |
| Comprehensive Income | \$46,540 | | | | | | |
| Cash dividends declared (\$1.13 per share) | | | | (29,775) | | | (29,775) |
| Treasury stock acquired (660,400 shares) | | | | | | (23,176) | (23,176) |
| Treasury stock issued for stock options exercised (330,735 shares) | | | 245 | | | 7,662 | 7,907 |
| Recognition of restricted stock compensation expense | | | 136 | | | | 136 |
| Tax benefit from nonstatutory stock options exercised | | | 1,660 | | | | 1,660 |
| Balance at December 31, 2005 | | \$ 74,285 | \$ 26,120 | \$ 326,158 | \$ 9,172 | \$ (83,314) | \$ 352,421 |
| Net income for 2006 | \$53,336 | | | 53,336 | | | 53,336 |
| Other comprehensive income, net of tax expense of \$743: | | | | | | | |
| Unrealized gains on securities of \$1,441 net of reclassification adjustment for gains included in net income of \$3,563 | (2,122) | | | | (2,122) | | (2,122) |
| Comprehensive Income | \$51,214 | | | | | | |
| Cash dividends declared (\$1.17 per share) | | | | (30,047) | | | (30,047) |
| Treasury stock acquired (122,244 shares) | | | | | | (35,269) | (35,269) |
| Treasury stock issued for stock options exercised (1,031,700 shares) | | | (435) | | | 3,190 | 2,755 |
| Recognition of restricted stock compensation expense | | | 59 | | | | 59 |
| Tax benefit from nonstatutory stock options exercised | | | 502 | | | | 502 |
| Recognition of nonstatutory stock option compensation expense | | | 452 | | | | 452 |
| Adjustment to initially apply SFAS No. 158, net of tax of \$1,635 | | | | | (3,036) | | (3,036) |
| Balance at December 31, 2006 | | \$ 74,285 | \$ 26,698 | \$ 349,447 | \$ 4,014 | \$ (115,393) | \$ 339,051 |

See Notes to Consolidated Financial Statements

PAGE 47

Table of Contents**CONSOLIDATED STATEMENTS OF CASH FLOWS****S&T Bancorp, Inc. and Subsidiaries**

| Year Ended December 31 <i>(dollars in thousands)</i> | 2006 | 2005 | 2004 |
|--|------------------|------------------|------------------|
| OPERATING ACTIVITIES | | | |
| Net Income | \$ 53,336 | \$ 58,243 | \$ 54,358 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for loan losses | 9,380 | 5,000 | 4,400 |
| Depreciation and amortization | 3,246 | 3,077 | 2,832 |
| Net amortization of investment security premiums | 967 | 1,119 | 2,200 |
| Recognition of stock-based compensation expense | 954 | | |
| Security gains, net | (5,481) | (5,008) | (5,344) |
| Deferred income taxes | 1,802 | 1,100 | (1,612) |
| Excess tax benefits from stock-based compensation | (294) | 1,660 | 2,098 |
| Mortgage loans originated for sale | (17,649) | (35,848) | (42,191) |
| Proceeds from the sale of loans | 18,760 | 36,354 | 42,983 |
| Gains on the sale of loans, net | (357) | (506) | (792) |
| (Increase) decrease in interest receivable | (1,501) | (2,513) | 677 |
| Increase in interest payable | 305 | 1,651 | 20 |
| (Increase) decrease in other assets | (9,398) | (12,243) | 61 |
| (Decrease) increase in other liabilities | (2,834) | (101) | 1,241 |
| Net Cash Provided by Operating Activities | 51,236 | 51,985 | 60,931 |
| INVESTING ACTIVITIES | | | |
| Net (increase) decrease in interest-earning deposits with banks | (1) | 97 | 2 |
| Proceeds from maturities of securities available for sale | 53,923 | 66,271 | 117,256 |
| Proceeds from sales of securities available for sale | 11,838 | 6,506 | 44,948 |
| Purchases of securities available for sale | (12,950) | (63,533) | (75,931) |
| Net increase in loans | (188,271) | (205,876) | (188,347) |
| Purchases of premises and equipment, net | (9,498) | (6,495) | (4,939) |
| Net Cash Used in Investing Activities | (144,959) | (203,030) | (107,011) |
| FINANCING ACTIVITIES | | | |
| Net increase in core deposits | 158,318 | 173,569 | 163,813 |
| Net (decrease) increase in time deposits | (11,895) | 69,052 | 50,199 |
| Net decrease in short-term borrowings | (95,000) | (75,000) | (9,650) |
| Net (decrease) increase in securities sold under repurchase agreements and federal funds purchased | (4,808) | 39,445 | (98,986) |
| Proceeds from long-term borrowings | 133,509 | 50,868 | 4,932 |
| Repayments of long-term borrowings | (45,344) | (53,417) | (35,540) |
| Proceeds from junior subordinated debt securities | 25,000 | | |
| Net treasury stock activity | (32,514) | (15,269) | (5,620) |
| Cash dividends paid to shareholders | (30,046) | (29,342) | (28,101) |
| Excess tax benefits from stock-based compensation | 294 | | |
| Net Cash Provided by Financing Activities | 97,514 | 159,906 | 41,047 |
| Increase (decrease) in Cash and Cash Equivalents | 3,791 | 8,861 | (5,033) |
| Cash and Cash Equivalents at Beginning of Year | 56,189 | 47,328 | 52,361 |
| Cash and Cash Equivalents at End of Year | \$ 59,980 | \$ 56,189 | \$ 47,328 |

See Notes to Consolidated Financial Statements

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

S&T Bancorp, Inc. and Subsidiaries

NOTE A

NATURE OF OPERATIONS

S&T Bancorp, Inc. (S&T) was incorporated on March 17, 1983 under the laws of the Commonwealth of Pennsylvania as a bank holding company and has two wholly owned subsidiaries, S&T Bank and 9th Street Holdings, Inc. S&T owns a one-half interest in Commonwealth Trust Credit Life Insurance Company (CTCLIC).

S&T is presently engaged in nonbanking activities through the following six entities: 9th Street Holdings, Inc., S&T Banc Holdings, Inc., CTCLIC, S&T Insurance Group, LLC, S&T Professional Resources Group, LLC and Stewart Capital Advisors, LLC. 9th Street Holdings, Inc. was formed in June 1988 and S&T Banc Holdings, Inc. was formed in August 2002 to hold and manage a group of investments previously owned by S&T Bank and to give S&T additional latitude to purchase other investments. CTCLIC, which is a joint venture with another financial institution, acts as a reinsurer of credit life, accident and health insurance policies sold by S&T Bank and the other institution. S&T Insurance Group, LLC distributes high-quality life insurance and long-term disability income insurance products through Evergreen Insurance Associates, LLC. S&T Professional Resources Group, LLC markets software developed by S&T. Stewart Capital Advisors, LLC was formed August 2005 to act as a registered investment advisor that manages private investment accounts for individuals and institutions and advises the Stewart Capital Mutual Fund.

ACCOUNTING POLICIES

The financial statements of S&T Bancorp, Inc. and subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the balance sheets and revenues and expenses for the periods. Actual results could differ from those estimates. The more significant accounting policies are described below.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of S&T and its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation. Investments of 20 percent – 50 percent of the outstanding common stock of investees are accounted for using the equity method of accounting. S&T operates within one business segment, community banking, providing a full range of services to individual and corporate customers.

CASH FLOW INFORMATION

Edgar Filing: S&T BANCORP INC - Form 10-K

S&T considers cash and due from banks as cash and cash equivalents. For the years ended December 31, 2006, 2005 and 2004, interest paid was \$92,006,000, \$61,213,000 and \$40,900,000, respectively. Income taxes paid during 2006 were \$22,143,000 compared to \$23,153,000 for 2005 and \$20,808,000 for 2004. For the years ended December 31, 2006, 2005 and 2004, transfers of loans to other real estate owned was \$523,000, \$3,455,000 and \$2,111,000, respectively.

SECURITIES

Management determines the appropriate classification of securities at the time of purchase. If management has the intent and S&T has the ability, at the time of purchase, to hold securities until maturity, they are classified as held to maturity and are stated at cost and adjusted for amortization of premiums and accretion of discounts. Securities to be held for indefinite periods of time are classified as available for sale and are recorded at market value, and unrealized gains and losses on these

PAGE 49

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

securities, net of related deferred income taxes, are reported in accumulated other comprehensive income. Gains or losses on the disposition of securities are based on the specific identification method. S&T does not engage in any securities trading activity for its own account.

Management systematically evaluates securities for other-than-temporary declines in market value. Securities for which declines in market value are deemed to be other-than-temporary are written down to current market value and the resultant changes included in earnings as realized losses.

LOANS

Interest on loans is accrued and credited to operations based on the principal amount outstanding. Accretion of discounts and amortization of premiums on loans are included in interest income. Loan origination fees and direct loan origination costs are deferred and amortized as an adjustment of loan yield over the respective lives of the loans. Loans are placed on nonaccrual and interest is discontinued generally when interest and principal are 90 days or more past due.

Impaired loans are defined by management as commercial and commercial real estate loans which it is probable that S&T will not be able to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status and underlying collateral value. All impaired loans are classified as substandard for risk classification purposes. Impaired loans are reserved, to the estimated value of collateral and/or cash flow associated with the loan, when management believes principal and interest will not be collected under the contractual terms of the loan. The accrual of interest on impaired loans is discontinued when the loan is 60 days past due or in management's opinion the account should be placed on nonaccrual status (loans partially charged-off are generally immediately placed on nonaccrual status). When interest accrual is discontinued, all unpaid accrued interest is reversed against interest income and/or the allowance for loan losses, as applicable. Interest income is subsequently recognized only to the extent that cash payments are received.

The allowance for loan losses is established through provisions for loan losses charged against income. Loans considered to be uncollectible are charged against the allowance, and recoveries, if any, are credited to the allowance. The adequacy of the allowance for loan losses is determined by management through evaluation of the loss exposure on individual nonperforming, delinquent and high-dollar loans; review of various risk conditions and business trends; historical loss experience; and growth and composition of the loan portfolio, as well as other relevant risk factors.

A quantitative analysis is utilized to support the adequacy of the allowance for loan losses. This analysis includes review of the historical charge-off rates for loan categories, fluctuations and trends in the amount of classified loans and other risk factors. Factors consider the level of S&T's historical charge-offs that have occurrence within the credits economic life cycle. Management also assesses subjective factors such as portfolio credit trends, unemployment trends, vacancy trends, loan growth and variable interest rate factors.

Significant to this analysis is the shift in loan portfolio composition to an increased mix of commercial loans. These loans are generally larger in size, and due to our continuing growth, many are new loan relationships. Management relies on its risk-rating process to monitor trends that may be occurring relative to commercial loans to assess potential weaknesses within the credit. Current factors and trends in risk ratings are considered in the determination and allocation of the allowance for loan losses.

S&T believes its quantitative and qualitative analysis and risk-rating process, which serves as the primary basis for assessing the adequacy of the allowance for loan losses, is sufficient to allow it to conclude that the total allowance for loan losses is adequate to absorb probable loan losses.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

LOANS ORIGINATED FOR SALE AND HELD FOR SALE

Loans held for sale consist of 1-4 family residential loans originated for sale in the secondary market and carried at lower of cost or market, determined on an aggregate basis. Loans held for sale were \$0.8 million and \$1.6 million at December 31, 2006 and 2005, respectively. Gains and losses on sales of loans held for sale are included in other income in the consolidated statements of income. S&T manages its exposure to changes in the market value of loans from the date of commitment to the borrower and the loan's ultimate sale by entering into mandatory forward commitments to sell the loans. The extent to which S&T elects to cover its loan production with forward commitments varies based upon factors deemed by management to be appropriate in the circumstances. The market value related to the risk of the commitment is the hedged asset or liability on the balance sheet with a corresponding offset recorded in the income statement. The adjustment to the hedged asset or liability is included in the basis of the hedged item, while the market value of the derivative is recorded as a freestanding asset or liability.

PREMISES AND EQUIPMENT

Premises and equipment are stated at cost less accumulated depreciation. Maintenance and repairs are charged to expense as incurred, while improvements which extend an asset's useful life are capitalized and depreciated over the estimated remaining life of the asset. Depreciation expense is computed generally by the straight-line method for financial reporting purposes and accelerated methods for income tax purposes. Useful lives range from three to 25 years for furniture and equipment; ten to 50 years for premises and two to 36 years for leasehold improvements. Leasehold improvements are amortized over the shorter of the asset's useful life or the remaining lease term, including renewal periods when reasonably assured pursuant to SFAS No. 13, Accounting for Leases.

JOINT VENTURES

S&T has limited partnership investments in affordable housing and federal historic rehabilitation projects, for which it provides funding as a limited partner and receives tax credits and tax deductions for any losses incurred by the projects based on its partnership share. At December 31, 2006 and 2005, S&T had recorded investments in other assets on its balance sheet of approximately \$15.7 million and \$13.7 million, respectively, associated with these investments. Low-income housing relationships are accounted for on the equity basis and are periodically reviewed for impairment. Investments in partnerships for the purpose of rehabilitating historic structures are evaluated for impairment at the end of each reporting period and are recorded at their net realizable value. S&T determined that it is not the primary beneficiary of these partnerships and does not consolidate them.

OTHER REAL ESTATE

Other real estate is included in other assets and is comprised of properties acquired through foreclosure proceedings or acceptance of a deed in lieu of a foreclosure. These properties are carried at the lower of cost or market value less estimated cost of resale. Loan losses arising from the acquisition of such property initially are charged against the allowance for loan losses. Gains or losses realized subsequent to acquisition are recorded in other expenses in the results of operations.

GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill represents the excess of the purchase price over the cost of net assets purchased. Goodwill is not amortized, but is evaluated for impairment annually. In 2006, 2005 and 2004, S&T performed the required impairment tests of goodwill at the respective reporting unit level and no impairment existed as of the valuation date, as the market value of S&T's net assets exceeded their carrying value.

PAGE 51

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

If, for any future period, S&T determines that there has been impairment in the carrying value of its goodwill balances, S&T will record a charge to earnings, which could have a material adverse effect on S&T's net income.

Intangible assets consist of \$3.8 million for the acquisition of core savings deposits (\$2.0 million, net of accumulated amortization) and \$1.5 million in cost for the acquisition of insurance contract relationships (\$0.9 million, net of accumulated amortization), and are amortized over their estimated weighted average lives of 11 years. The estimated aggregate amortization expense for each of the five succeeding years will approximate \$0.5 million.

| | Core | |
|-------------------------------------|------------------|-------------------|
| | Deposit | |
| | Goodwill | Intangible |
| <i>dollars in thousands</i> | | |
| Balance at December 31, 2004 | \$ 48,021 | \$ 3,507 |
| Additions | 1,052 | 276 |
| Amortization | | (483) |
| Balance at December 31, 2005 | \$ 49,073 | \$ 3,300 |
| Additions | 882 | 111 |
| Amortization | | (494) |
| Balance at December 31, 2006 | \$ 49,955 | \$ 2,917 |

MORTGAGE LOAN SERVICING

Mortgage servicing assets are recognized as separate assets when servicing rights are acquired through loan originations when the underlying loan is sold. Upon sale, the mortgage servicing right is established, which represents the then current market value of future net cash flows expected to be realized for performing the servicing activities. The market value of the mortgage servicing rights are estimated by calculating the present value of estimated future net servicing cash flows, taking into consideration actual and expected mortgage loan prepayment rates, discount rates, servicing costs and other economic factors, which are determined based on current market conditions. The expected and actual rates of mortgage loan prepayments are the most significant factors driving the value of mortgage servicing rights. Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced. In determining the market value of the mortgage servicing rights, mortgage interest rates, which are used to determine prepayment rates and discount rates, are held constant over the estimated life of the portfolio. Capitalized mortgage servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying mortgage loans.

Capitalized mortgage servicing rights are regularly evaluated for impairment based on the estimated market value of those rights. The mortgage servicing rights are stratified by certain risk characteristics, primarily loan term and note rate. If temporary impairment exists within a risk stratification tranche, a valuation allowance is established through a charge to income equal to the amount by which the carrying value exceeds the market value. If it is later determined all or a portion of the temporary impairment no longer exists for a particular tranche, the valuation allowance is reduced.

Mortgage servicing rights are also reviewed for other-than-temporary impairment. Other-than-temporary impairment exists when the recoverability of a recorded valuation allowance is determined to be remote, taking into consideration historical and projected interest rates and loan pay-off activity. When this situation occurs, the unrecoverable portion of the valuation allowance is applied

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

as a direct write-down to the carrying value of the mortgage servicing rights. Unlike a valuation allowance, a direct write-down permanently reduces the carrying value of the mortgage servicing rights and the valuation allowance, precluding subsequent recoveries.

For the year ended December 31, 2006 and 2005, the 1-4 family mortgage loans that were sold to Fannie Mae amounted to \$18.8 million and \$36.4 million, respectively. At December 31, 2006 and 2005, mortgage servicing rights were \$2.1 million and \$2.2 million, respectively. At December 31, 2006, 2005 and 2004, S&T's servicing portfolio totaled \$180.8 million, \$185.1 million and \$175.9 million, respectively. The fair market value of mortgage servicing rights was \$2.2 million and \$2.4 million at December 31, 2006 and 2005, respectively.

| | Servicing Rights | Valuation Allowance | Net Carrying Value |
|-------------------------------------|---------------------|------------------------|-----------------------|
| <i>Dollars in thousands</i> | | | |
| Balance at December 31, 2004 | \$ 2,063 | \$ 389 | \$ 1,674 |
| Additions/(reductions) | 421 | (369) | 790 |
| Amortization | (286) | | (286) |
| Balance at December 31, 2005 | 2,198 | 20 | 2,178 |
| Additions/(reductions) | 239 | 36 | 203 |
| Amortization | (313) | | (313) |
| Balance at December 31, 2006 | \$ 2,124 | \$ 56 | \$ 2,068 |

DERIVATIVE FINANCIAL INSTRUMENTS

S&T utilizes derivative instruments from time to time for asset/liability management. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations and payments are based. The notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Interest-rate swaps are contracts in which a series of interest-rate flows (fixed and floating) are exchanged over a prescribed period. The notional amounts on which the interest payments are based are not exchanged.

S&T has certain interest rate derivative positions that are not designated as hedging instruments. These derivative positions relate to transactions in which S&T enters into an interest-rate swap with a customer while at the same time entering into an offsetting interest-rate swap with another financial institution. In connection with each transaction, S&T agrees to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a same notional amount at a fixed rate. At the same time, S&T agrees to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows S&T's customer to effectively convert a variable rate loan to a fixed rate for the customer. Because S&T acts as an intermediary for its customer, changes in the market value of the underlying derivative contracts offset each other and do not impact S&T's results of operations.

S&T offers rate lock commitments to potential borrowers. The commitments are generally for 60 days and guarantee a specified interest rate for a loan if underwriting standards are met, but the commitment does not obligate the potential borrower to close on the loan. Accordingly, some commitments expire prior to becoming loans. S&T enters into such contracts in order to control interest rate risk under an asset/liability strategy that is meant to limit risk from holding longer-term mortgages. Whenever a customer desires these products, a mortgage originator quotes a secondary market rate, guaranteed for that day by the investor. The rate lock is executed between the mortgagee

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

and S&T, and in turn a forward sales contract is executed between S&T and the investor. Both the rate lock commitment and the corresponding forward sales contract for each customer are considered derivatives. As such, changes in the fair value of the derivatives during the commitment period are recorded in current earnings and included in other income on the consolidated statements of income.

WEALTH MANAGEMENT ASSETS AND INCOME

Assets held in a fiduciary capacity by the subsidiary bank, S&T Bank, are not assets of S&T Bank and are therefore not included in the consolidated financial statements. Wealth management fee income is reported on the consolidated statement of income.

STOCK-BASED COMPENSATION

S&T has various stock-based employee compensation plans, which are described in Note O. S&T adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard (SFAS) No. 123(R), Share Based Payment, on January 1, 2006. S&T is applying the modified prospective method. SFAS No. 123(R) requires measurement of compensation expense of all stock-based awards at market value on the date of grant and recognition of compensation expense over the service period for all awards granted or not yet vested at the date of adoption. As a result of applying the provisions of SFAS No. 123(R), during 2006, S&T recognized compensation expense of \$776,000, pretax and \$505,000, net of tax. The effect of applying the provisions of SFAS No. 123(R) to both year-to-date basic earnings per share and diluted earnings per share was a decrease of \$0.02.

Prior to the adoption of SFAS No. 123(R), S&T applied APB Opinion No. 25, Accounting for Stock Issued to Employees, in accounting for stock-based awards. No compensation expense was reflected in net income for 2005 and 2004. Results for prior periods have not been restated.

The following table illustrates the effect on net income and earnings per share if the market value method had been applied to all outstanding and unvested awards in each period.

| | 2005 | 2004 |
|---|------------------|------------------|
| <i>(dollars in thousands, except per share data)</i> | | |
| Net Income | \$ 58,243 | \$ 54,358 |
| Stock-based employee compensation cost determined if the market value method had been applied to all awards, net of tax | (2,173) | (1,324) |
| Proforma Net Income | \$ 56,070 | \$ 53,034 |
| Basic Earnings per Share | | |
| As reported | \$ 2.21 | \$ 2.05 |
| Proforma | 2.13 | 2.00 |
| Diluted Earnings per Share | | |
| As reported | \$ 2.18 | \$ 2.03 |
| Proforma | 2.10 | 1.98 |

On June 20, 2005, the Board of Directors approved the accelerated vesting of the December 20, 2004 stock options awarded to eligible participants under the S&T Bancorp, Inc. 2003 Stock Incentive Plan (the 2003 Stock Plan), which had an exercise price of \$37.08. As a result of

Edgar Filing: S&T BANCORP INC - Form 10-K

the acceleration, unvested options granted in 2004 to acquire approximately 381,000 shares of S&T's common stock, which otherwise 50 percent would have vested on January 1, 2006 and the remaining shares on January 1, 2007, became immediately exercisable. The options were not in the money (i.e., the exercise price of the options were in excess of the price of S&T's common stock) at the time of acceleration.

PAGE 54

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The Black-Scholes option valuation model was developed for use in estimating the market value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. S&T's employee stock options have characteristics significantly different from those of traded options, and changes in subjective input assumptions can materially affect the market value estimate. For the stock option grants awarded in 2006 and 2005, S&T followed the short-cut approach, in developing the estimate of expected life. Under this approach, the expected life is presumed to be the mid point between the vesting date and the end of the contractual term.

The market value for nonstatutory stock options were estimated at the grant dates using a Black-Scholes option pricing model with the following weighted-average assumptions for 2006, 2005, and 2004, respectively: risk-free interest rates of 4.36 percent, 3.61 percent and 3.27 percent; a dividend yield of 3.0 percent, 2.9 percent and 3.3 percent; volatility of the expected market price of S&T's common stock of .27, .26, and .27; and a weighted-average expected life of seven years, five years and five years.

S&T maintains a Cash Appreciation Rights (CARs) plan, which are treated as liability instruments under SFAS No. 123(R). The current market value must be determined at each reporting date. The Black-Scholes option valuation model was used to determine the market value of the CARs as of December 31, 2006. The assumptions used to value the CARs are as follows: a risk-free interest rate of 4.64 percent; a dividend yield of 3.53 percent; volatility of the expected market price of S&T's common stock of .26; and a weighted-average expected life of 5.98 years.

PENSIONS

Pension expense for S&T Bank's defined benefit pension plan is actuarially determined using the projected unit credit actuarial cost method. The funding policy for the plan is to contribute amounts to the plan sufficient to meet the minimum funding requirements of the Employee Retirement Income Security Act of 1974, plus such additional amounts as may be appropriate, subject to federal income tax limitation.

INCOME TAXES

Income taxes are accounted for under the liability method whereby deferred income taxes are recognized for the difference between the financial reporting and tax bases of assets and liabilities.

TREASURY STOCK

The purchase of S&T common stock is recorded at cost. At the time of reissuance, the treasury stock account is reduced using the average cost method.

EARNINGS PER COMMON SHARE

Edgar Filing: S&T BANCORP INC - Form 10-K

Basic Earnings Per Share (EPS) is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Average shares outstanding for computing basic EPS were 25,735,295, 26,384,062 and 26,485,934 for 2006, 2005 and 2004, respectively. Potentially dilutive securities are excluded from the basic calculation, but are included in diluted EPS. Average shares outstanding for computing diluted EPS were 25,940,352, 26,688,148 and 26,799,451 for 2006, 2005 and 2004, respectively. In computing diluted EPS, average shares outstanding have been increased by the common stock equivalents relating to S&T 's outstanding stock options.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments. Under current generally accepted accounting principles, an entity that holds a financial

PAGE 55

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

instrument with an embedded derivative must bifurcate the financial instrument, resulting in the host and the embedded derivative being accounted for separately. SFAS No. 155 permits, but does not require, entities to account for certain financial instruments with an embedded derivative at fair value thereby eliminating the need to bifurcate the instrument into its host and the embedded derivative. This Statement will be effective for all financial instruments acquired or issued by S&T on or after January 1, 2007, and is not expected to have a significant impact on S&T's financial position or results of operations.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets*. This Statement amends SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 requires companies to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract. The Statement permits a company to choose either the amortized cost method or fair value measurement method for each class of separately recognized servicing assets. This Statement will be effective as of January 1, 2007 and is not expected to have a significant impact on S&T's financial position and results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of SFAS No. 109, *Accounting for Income Taxes*, to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. S&T will adopt FIN 48 as of January 1, 2007, as required. The cumulative effect of adopting FIN 48 will be recorded in retained earnings. Upon adoption, management estimates that the cumulative effect adjustment will be immaterial to retained earnings, which is subject to revision as management completes its analysis.

In September 2006, the FASB issued, SFAS No. 157, *Fair Value Measurements*. This standard provides enhanced guidance for using fair value to measure assets and liabilities. The standard also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. S&T will be required to apply the new guidance effective January 1, 2008. S&T is in the process of determining the impact on S&T's financial position and results of operations.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of SFASB No. 87, 88, 106 and 132(R). SFAS No. 158 requires companies to recognize the over funded or under funded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Statement improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position. On December 31, 2006, S&T adopted the recognition and disclosure provisions of SFAS No. 158, which resulted in the recognition of the funded status of its pension and postretirement plans as either assets or liabilities on the consolidated balance sheet and recognition of unrecognized actuarial gains/losses and prior service costs of \$3.0 million as a separate component of accumulated comprehensive income, net of tax. SFAS No. 158 did not have an effect on S&T's consolidated financial condition at December 31, 2005 or 2004. SFAS No. 158's provisions regarding the change in the measurement date of defined

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

postretirement benefit plans are not applicable as S&T already uses a measurement date of December 31 for its pension plan. See Note N for further discussion of the effect of adopting SFAS No. 158 on S&T's consolidated financial statements.

RECLASSIFICATION

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation. The reclassifications had no effect on S&T's financial condition or results of operations.

NOTE B

Market Values of Financial Instruments

S&T utilizes quoted market values, where available, to assign market value to its financial instruments. In cases where quoted market values were not available, S&T uses present value methods to estimate the market value of its financial instruments. These estimates of market value are significantly affected by the assumptions made and, accordingly, do not necessarily indicate amounts that could be realized in a current market exchange.

The following methods and assumptions were used by S&T in estimating its market value disclosures for financial instruments:

CASH AND CASH EQUIVALENTS AND OTHER SHORT-TERM ASSETS

The carrying amounts reported in the consolidated balance sheet for cash and due from banks, interest-earning deposits with banks and federal funds sold approximate those assets' market values.

SECURITIES

Market values for investment securities and securities available for sale are based on quoted market prices.

LOANS

Edgar Filing: S&T BANCORP INC - Form 10-K

For variable-rate loans that reprice frequently and with no significant change in credit risk, market values are based on carrying values. The market values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers as adjusted for net credit losses and the loss of interest income from nonaccrual loans. The carrying amount of accrued interest approximates its market value.

DEPOSITS

The market values disclosed for demand deposits (e.g., noninterest and interest-bearing demand, money market and savings accounts) are, by definition, equal to the amount payable on demand. The carrying amounts for variable-rate, fixed-term, and certificates of deposit approximate their market value at year-end. Market values for fixed-rate certificates of deposit and other time deposits are based on the discounted value of contractual cash flows, using interest rates currently offered for deposits of similar remaining maturities.

SHORT-TERM BORROWINGS AND OTHER BORROWED FUNDS

The carrying amounts of federal funds purchased, securities sold under repurchase agreements and other borrowings approximate their market values.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued****LONG-TERM BORROWINGS**

The market values disclosed for long-term borrowings are estimated using current interest rates for long-term borrowings of similar remaining maturities.

LOAN COMMITMENTS AND STANDBY LETTERS OF CREDIT

Estimates of the market value of these off-balance sheet items were not made because of the short-term nature of these arrangements and the credit standing of the counter-parties. Also, unfunded loan commitments relate principally to variable-rate commercial loans, typically non-binding and fees are not normally assessed on these balances.

Estimates of market value have not been made for items that are not defined as financial instruments, including such items as S&T's core deposit intangibles and the value of its trust operation. S&T believes it is impractical to estimate a representational market value for these types of assets, which represent significant value to S&T.

The following table indicates the estimated market value of S&T's financial instruments as of December 31:

| | 2006 | | 2005 | |
|---|--------------|----------------|--------------|----------------|
| | Market Value | Carrying Value | Market Value | Carrying Value |
| <i>(dollars in thousands)</i> | | | | |
| ASSETS | | | | |
| Cash | \$ 59,980 | \$ 59,980 | \$ 56,189 | \$ 56,189 |
| Securities available for sale | 432,045 | 432,045 | 481,257 | 481,257 |
| Other investments | 10,562 | 10,562 | 13,318 | 13,318 |
| Loans | 2,663,743 | 2,666,291 | 2,473,390 | 2,491,506 |
| LIABILITIES | | | | |
| Deposits | \$ 2,561,929 | \$ 2,565,306 | \$ 2,412,412 | \$ 2,418,884 |
| Securities sold under repurchase agreements & federal funds purchased | 132,751 | 133,021 | 137,829 | 137,829 |
| Short-term borrowings | 55,000 | 55,000 | 150,000 | 150,000 |
| Long-term borrowings | 173,122 | 171,941 | 84,967 | 83,776 |
| Junior subordinated debt securities | 25,115 | 25,000 | | |
| Interest-rate swaps | | | | |

NOTE C**Restrictions on Cash and Due from Bank Accounts**

The Board of Governors of the Federal Reserve System (the Federal Reserve Board) imposes certain reserve requirements on all depository institutions. These reserves are maintained in the form of vault cash or as a noninterest-bearing balance with the Federal Reserve Board.

Required reserves averaged \$17,593,000 during 2006.

PAGE 58

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued****NOTE D****Securities**

The following table indicates the composition of the securities portfolio at December 31:

| | Amortized | Available for Sale | | Market |
|--|-------------------|--------------------|-------------------|-------------------|
| | | Gross | Gross | |
| | | Unrealized | Unrealized | |
| | Cost | Gains | Losses | Value |
| 2006 | | | | |
| <i>(dollars in thousands)</i> | | | | |
| Obligations of U.S. government corporations and agencies | \$ 183,161 | \$ 16 | \$ (3,174) | \$ 180,003 |
| Collateralized mortgage obligations of U.S. government corporations and agencies | 61,087 | | (997) | 60,090 |
| Mortgage-backed securities | 32,856 | 15 | (1,078) | 31,793 |
| Obligations of states and political subdivisions | 82,733 | 37 | (1,098) | 81,672 |
| Debt securities available for sale | 359,837 | 68 | (6,347) | 353,558 |
| Marketable equity securities | 39,268 | 16,126 | (45) | 55,349 |
| Other securities | 23,138 | | | 23,138 |
| Total | \$ 422,243 | \$ 16,194 | \$ (6,392) | \$ 432,045 |

| | Amortized | Available for Sale | | Market |
|--|-------------------|--------------------|-------------------|-------------------|
| | | Gross | Gross | |
| | | Unrealized | Unrealized | |
| | Cost | Gains | Losses | Value |
| 2005 | | | | |
| <i>(dollars in thousands)</i> | | | | |
| Obligations of U.S. government corporations and agencies | \$ 224,325 | \$ 399 | \$ (3,687) | \$ 221,037 |
| Collateralized mortgage obligations of U.S. government corporations and agencies | 64,480 | 6 | (847) | 63,639 |
| Mortgage-backed securities | 39,321 | 46 | (951) | 38,416 |
| U.S. treasury securities | 499 | | | 499 |
| Obligations of states and political subdivisions | 84,998 | 38 | (1,225) | 83,811 |
| Debt securities available for sale | 413,623 | 489 | (6,710) | 407,402 |
| Marketable equity securities | 45,421 | 20,084 | (391) | 65,114 |
| Other securities | 8,741 | | | 8,741 |
| Total | \$ 467,785 | \$ 20,573 | \$ (7,101) | \$ 481,257 |

There were \$6,069,000, \$5,337,000 and \$6,348,000 in gross realized gains and \$588,000, \$329,000 and \$1,004,000 in gross realized losses in 2006, 2005 and 2004, in each case respectively, relative to securities available for sale.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

The following table presents the age of gross unrealized losses and market value by investment category:

| 2006 <i>(dollars in thousands)</i> | Less Than 12 Months | | 12 Months or More | | Total | |
|--|---------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | Market Value | Unrealized Losses | Market Value | Unrealized Losses | Market Value | Unrealized Losses |
| Obligations of U.S. government corporations and agencies | \$ | \$ | \$ 175,041 | \$ (3,174) | \$ 175,041 | \$ (3,174) |
| Collateralized mortgage obligations of U.S. government corporations and agencies | 9,515 | (29) | 50,575 | (968) | 60,090 | (997) |
| Mortgage-backed securities | | | 30,535 | (1,078) | 30,535 | (1,078) |
| Obligations of states and political subdivisions | 9,948 | (24) | 65,731 | (1,074) | 75,679 | (1,098) |
| Debt securities available for sale | 19,463 | (53) | 321,882 | (6,294) | 341,345 | (6,347) |
| Marketable equity securities | 989 | (45) | | | 989 | (45) |
| Total Temporarily Impaired Securities | \$ 20,452 | \$ (98) | \$ 321,882 | \$ (6,294) | \$ 342,334 | \$ (6,392) |

| 2005 <i>(dollars in thousands)</i> | Less Than 12 Months | | 12 Months or More | | Total | |
|--|---------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | Market Value | Unrealized Losses | Market Value | Unrealized Losses | Market Value | Unrealized Losses |
| Obligations of U.S. government corporations and agencies | \$ 142,892 | \$ (2,553) | \$ 32,825 | \$ (1,134) | \$ 175,717 | \$ (3,687) |
| Collateralized mortgage obligations of U.S. government corporations and agencies | 58,696 | (847) | | | 58,696 | (847) |
| Mortgage-backed securities | 21,450 | (360) | 14,466 | (591) | 35,916 | (951) |
| Obligations of states and political subdivisions | 58,898 | (753) | 14,412 | (472) | 73,310 | (1,225) |
| Debt securities available for sale | 281,936 | (4,513) | 61,703 | (2,197) | 343,639 | (6,710) |
| Marketable equity securities | 3,052 | (245) | 2,857 | (146) | 5,909 | (391) |
| Total Temporarily Impaired Securities | \$ 284,988 | \$ (4,758) | \$ 64,560 | \$ (2,343) | \$ 349,548 | \$ (7,101) |

During 2006, S&T recognized other-than-temporary impairments totaling \$0.3 million on three equity investment securities. S&T recognized an other-than-temporary impairment totaling \$0.3 million on one equity security during 2005 and zero during 2004. S&T does not believe any individual unrealized loss as of December 31, 2006 represents an other-than-temporary impairment. S&T performs a review on the entire securities portfolio on a quarterly basis to identify securities that may

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

indicate an other-than-temporary impairment. S&T management considers the length of time and the extent to which the market value has been less than cost and the financial condition of the issuer. The unrealized losses on 180 debt securities are primarily attributable to changes in interest rates. The unrealized losses on three marketable equity securities are attributable to temporary declines in market value. S&T has both the intent and the ability to hold the securities contained in the previous table for a time necessary to recover the amortized cost or until maturity.

The amortized cost and estimated market value of debt securities at December 31, 2006, by effective maturity, is included in the table below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

For purposes of the maturity table, mortgage-backed securities and collateralized mortgage obligations, which are not due at a single maturity date, have been allocated over maturity groupings based upon the current estimated prepayment rates. The mortgage-backed securities and collateralized mortgage obligations may mature earlier or later than their estimated maturities because of principal prepayment optionality.

| | Amortized | Market |
|---|-------------------|-------------------|
| | Cost | Value |
| Available for Sale | | |
| <i>(dollars in thousands)</i> | | |
| Due in one year or less | \$ 56,649 | \$ 56,057 |
| Due after one year through five years | 261,752 | 256,911 |
| Due after five years through ten years | 38,630 | 37,855 |
| Due after ten years | 2,806 | 2,735 |
| Total Debt Securities Available for Sale | \$ 359,837 | \$ 353,558 |

At December 31, 2006 and 2005, securities with principal amounts of \$287,994,000 and \$274,399,000, respectively, were pledged to secure repurchase agreements, public funds and trust fund deposits.

NOTE E**Loans**

The following table indicates the composition of the loan portfolio at December 31:

| | 2006 | 2005 |
|-------------------------------|------------------|------------------|
| <i>(dollars in thousands)</i> | | |
| Real estate construction | \$ 346,173 | \$ 332,930 |
| Real estate mortgages: | | |
| Residential | 570,304 | 523,745 |
| Commercial | 973,015 | 920,349 |
| Commercial and industrial | 702,833 | 644,686 |
| Consumer installment | 73,140 | 68,216 |
| Gross Portfolio Loans | 2,665,465 | 2,489,926 |
| Allowance for loan losses | (33,220) | (36,572) |

Edgar Filing: S&T BANCORP INC - Form 10-K

| | | |
|------------------------------|---------------------|---------------------|
| Total Portfolio Loans | 2,632,245 | 2,453,354 |
| Loans held for sale | 826 | 1,580 |
| Total Loans | \$ 2,633,071 | \$ 2,454,934 |

PAGE 61

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

The following table presents changes in the allowance for loan losses for the year ended December 31:

| | 2006 | 2005 | 2004 |
|--|------------------|------------------|------------------|
| <i>(dollars in thousands)</i> | | | |
| Balance at beginning of year | \$ 36,572 | \$ 34,262 | \$ 31,478 |
| Charge-offs | (14,038) | (3,929) | (7,175) |
| Recoveries | 1,306 | 2,208 | 5,559 |
| Net charge-offs | (12,732) | (1,721) | (1,616) |
| Provision for loan losses | 9,380 | 5,000 | 4,400 |
| Reclassification of allowance for lending-related commitments ⁽¹⁾ | | (969) | |
| Balance at end of year | \$ 33,220 | \$ 36,572 | \$ 34,262 |

(1) During the second quarter of 2005, S&T reclassified \$969,000 of its allowance for loan losses to a separate allowance for probable credit losses inherent in lending-related commitments. Net income and prior period balances were not affected by this reclassification. The separate allowance is included in other liabilities.

S&T Bank has granted loans to certain officers and directors of S&T as well as to certain affiliates of the officers and directors in the ordinary course of business. These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and did not involve more than normal risk of collectability. The aggregate dollar amounts of these loans were \$32,714,000 and \$32,136,000 at December 31, 2006 and 2005, respectively. During 2006, \$15,196,000 of new loans were funded and repayments totaled \$14,618,000.

The principal balances of loans on nonaccrual status were \$19,852,000 and \$11,166,000 at December 31, 2006 and 2005, respectively. Other real estate owned which is included in other assets, was \$523,000 at December 31, 2006 and \$3,712,000 at December 31, 2005.

S&T attempts to limit its exposure to concentrations of credit risk by diversifying its loan portfolio. S&T monitors concentrations of credit risk. At December 31, 2006 and 2005, S&T had no concentrations of credit risk by industry or group. Geographic concentrations exist because S&T provides a full range of banking services, including commercial, consumer and mortgage loans to individuals and corporate customers in its ten-county market areas in western Pennsylvania. Management believes these risks are mitigated by underwriting guidelines and ongoing review by loan administration.

The following table represents S&T's investment in loans considered to be impaired and related information on those impaired loans:

| | 2006 | 2005 | 2004 |
|---|-----------|-----------|-----------|
| <i>(dollars in thousands)</i> | | | |
| Recorded investment in loans considered to be impaired | \$ 26,152 | \$ 29,745 | \$ 10,458 |
| Recorded investment in impaired loans with no related allowance for loan losses | 19,698 | 7,741 | 1,388 |
| Loans considered to be impaired that were on a nonaccrual basis | 8,617 | 5,507 | 2,138 |
| Allowance for loan losses related to loans considered to be impaired | 2,627 | 9,937 | 5,712 |
| Average recorded investment in impaired loans | 31,426 | 16,325 | 13,762 |
| Total interest income per contractual terms on impaired loans | 2,675 | 2,115 | 684 |
| Interest income on impaired loans recognized on a cash basis | 1,867 | 1,854 | 571 |

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued****NOTE F****Premises and Equipment**

The following table is a summary of the premises and equipment accounts at December 31:

| <i>(dollars in thousands)</i> | Estimated Useful Life | 2006 | 2005 |
|-------------------------------|--------------------------|------------------|------------------|
| Land | Indefinite | \$ 4,738 | \$ 4,530 |
| Premises | 10-50 years | 35,746 | 29,949 |
| Furniture and equipment | 3-25 years | 24,704 | 21,957 |
| Leasehold improvements | 2-36 years | 3,376 | 3,944 |
| | | 68,564 | 60,380 |
| Accumulated depreciation | | (32,864) | (31,257) |
| Total | | \$ 35,700 | \$ 29,123 |

Depreciation related to premises and equipment was \$2,922,000, \$2,863,000 and \$2,485,000 in 2006, 2005 and 2004, respectively.

Certain banking facilities are leased under short-term lease arrangements expiring at various dates to the year 2051. All such leases are accounted for as operating leases. Rental expense for premises and equipment amounted to \$2,555,000, \$2,229,000 and \$1,963,000 in 2006, 2005 and 2004, respectively. Minimum annual rentals and renewal options for each of the years 2007-2011 are approximately \$1,089,000, \$1,060,000, \$1,019,000, \$1,003,000, and \$993,000, respectively, and \$15,004,000 for the years thereafter. Included in the above are leases entered into with three directors for which rental expense totaled \$557,000, \$611,000 and \$575,000 in 2006, 2005 and 2004, respectively.

NOTE G**Deposits**

The following table indicates the composition of deposits at December 31:

| <i>(dollars in thousands)</i> | 2006 | | 2005 | |
|-------------------------------|---------------------|------------------|---------------------|------------------|
| | Balance | Expense | Balance | Expense |
| Noninterest-bearing demand | \$ 448,453 | \$ | \$ 435,672 | \$ |
| Interest-bearing demand | 150,568 | 60 | 155,191 | 21 |
| Money market | 163,105 | 3,736 | 242,228 | 3,812 |
| Savings | 881,967 | 32,787 | 652,685 | 11,263 |
| Time deposits | 921,213 | 36,946 | 933,108 | 29,728 |
| Total | \$ 2,565,306 | \$ 73,529 | \$ 2,418,884 | \$ 44,824 |

Edgar Filing: S&T BANCORP INC - Form 10-K

The aggregate of all time deposits over \$100,000 amounted to \$261,646,000 and \$206,666,000 for December 31, 2006 and 2005, respectively.

PAGE 63

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

The following table indicates the scheduled maturities of time deposits at December 31:

| | 2006 | 2005 |
|-------------------------------|-------------------|-------------------|
| <i>(dollars in thousands)</i> | | |
| Due in one year | \$ 659,530 | \$ 548,150 |
| Due in one to two years | 161,689 | 198,753 |
| Due in two to three years | 55,100 | 102,937 |
| Due in three to four years | 15,440 | 38,479 |
| Due in four to five years | 20,117 | 21,200 |
| Due after five years | 9,337 | 23,589 |
| Total | \$ 921,213 | \$ 933,108 |

NOTE H**Short-Term Borrowings**

Short-term borrowings are for terms under one year and were comprised of retail repurchase agreements (REPOs), wholesale REPOs, federal funds purchased and FHLB advances. S&T defines repurchase agreements with its local retail customers as retail REPOs; short-term wholesale REPOs are those transacted with other banks and brokerage firms. Securities pledged as collateral under these REPO financing arrangements cannot be sold or repledged by the secured party. The fair value of collateral provided to a third party is continually monitored, and additional collateral is obtained or requested to be returned as appropriate. Federal funds purchased are unsecured overnight borrowings with other financial institutions; overnight and FHLB advances are for various terms secured by a blanket lien on securities, residential mortgages and other loans with the FHLB of Pittsburgh.

Securities Sold Under Repurchase Agreements and

| Federal Funds Purchased | 2006 | 2005 | 2004 |
|---|-------------|-------------|-------------|
| <i>(dollars in thousands)</i> | | | |
| Balance at December 31: | \$ 133,021 | \$ 137,829 | \$ 98,384 |
| Average balance during the year | 114,544 | 132,406 | 164,645 |
| Average interest rate during the year | 4.51% | 2.98% | 1.16% |
| Maximum month-end balance during the year | \$ 156,471 | \$ 174,467 | \$ 199,538 |
| Average interest rate at year-end | 4.83% | 3.80% | 1.77% |
| Federal Home Loan Bank (FHLB) Advances | | | |
| <i>(dollars in thousands)</i> | | | |
| Balance at December 31: | \$ 55,000 | \$ 150,000 | \$ 225,000 |
| Average balance during the year | 88,342 | 221,918 | 293,391 |
| Average interest rate during the year | 5.01% | 3.21% | 1.47% |
| Maximum month-end balance during the year | \$ 150,000 | \$ 315,000 | \$ 380,000 |
| Average interest rate at year-end | 5.44% | 4.34% | 2.20% |

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued****NOTE I****Long-Term Borrowings**

The following table is a summary of long-term borrowings with the FHLB:

| | 2006 | | 2005 | |
|-------------------------------|-------------------|--------------|------------------|--------------|
| | Balance | Average Rate | Balance | Average Rate |
| <i>(dollars in thousands)</i> | | | | |
| Due in one year | \$ 20,920 | 5.39% | \$ 45,344 | 3.79% |
| Due in one to two years | 50,965 | 5.05% | 10,362 | 5.70% |
| Due in two to three years | 84,429 | 5.49% | 379 | 4.88% |
| Due in three to four years | 5,760 | 6.41% | 13,638 | 6.08% |
| Due in four to five years | 564 | 4.89% | 4,929 | 6.67% |
| Due after five years | 9,303 | 5.26% | 9,124 | 4.86% |
| Total | \$ 171,941 | 5.36% | \$ 83,776 | 4.69% |

The purpose of these borrowings is to match-fund selected new loan originations, to mitigate interest-rate sensitivity risks and to take advantage of discounted borrowing rates through the FHLB for community investment projects.

S&T pledged securities and all 1-4 family and multi-family mortgage loans as collateral for any current or future FHLB borrowings. The total carrying amount of these pledged loans was \$443,734,000 at December 31, 2006. At December 31, 2006, S&T had availability with the FHLB of \$516,518,000.

At December 31, 2006, S&T had long-term repurchase agreement borrowings totaling \$50.0 million at a weighted average fixed-rate of 5.52 percent, which matures within one year. At December 31, 2005, S&T had no long-term repurchase agreement borrowings outstanding. The purpose of these borrowings was to lock in fixed-rate fundings to mitigate interest-rate risk.

On September 21, 2006, S&T Bank issued \$25.0 million of junior subordinated debt through a pooled transaction at an initial fixed rate of 6.78%. On September 15, 2011 and quarterly thereafter, S&T Bank has the option to redeem the subordinated debt, subject to a 30 day written notice and prior approval by the FDIC. If S&T Bank chooses not to exercise the option for early redemption on September 15, 2011 or subsequent quarters, the subordinated debt will convert to a variable rate of 3-month LIBOR plus 160 basis points. The subordinated debt qualifies as Tier 2 capital under regulatory guidelines and will mature on December 15, 2036.

NOTE J**Dividend and Loan Restrictions**

Certain restrictions exist regarding the ability of S&T Bank to transfer funds to S&T in the form of dividends and loans. The amount of dividends that may be paid to S&T is restricted by regulatory guidelines concerning minimum capital requirements. S&T Bank could pay dividends of approximately \$18.5 million without affecting its well-capitalized position at December 31, 2006.

Edgar Filing: S&T BANCORP INC - Form 10-K

Federal law prohibits S&T from borrowing from S&T Bank unless such loans are collateralized by specific obligations. Further, such loans are limited to 10 percent of S&T Bank's capital and additional paid-in capital, as defined.

PAGE 65

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE K**Litigation**

S&T, in the normal course of business, is subject to various legal proceedings in which claims for monetary damages are asserted. No material losses are anticipated by S&T as a result of these legal proceedings.

NOTE L**Guarantees**

S&T, in the normal course of business, commits to extend credit and issue standby letters of credit. The obligations are not recorded in S&T's financial statements. Loan commitments and standby letters of credit are subject to S&T's normal credit underwriting policies and procedures and generally require collateral based upon management's evaluation of each customer's financial condition and ability to satisfy completely the terms of the agreement. S&T's exposure to credit loss, in the event the customer does not satisfy the terms of the agreement, equals the notional amount of the obligation less the value of any collateral. Unfunded commercial loan commitments totaled \$686,204,000 and \$635,809,000 at December 31, 2006 and 2005, respectively. Unfunded other loan commitments totaled \$157,863,000 and \$144,694,000 at December 31, 2006 and 2005, respectively; and obligations under standby letters of credit totaled \$220,494,000 and \$206,249,000 at December 31, 2006 and 2005, respectively.

NOTE M**Income Taxes**

Income tax expense (credits) for the years ended December 31 are comprised of:

| | 2006 | 2005 | 2004 |
|-------------------------------|------------------|------------------|------------------|
| <i>(dollars in thousands)</i> | | | |
| Current | \$ 19,711 | \$ 23,288 | \$ 24,613 |
| Deferred | 1,802 | 999 | (1,612) |
| Total | \$ 21,513 | \$ 24,287 | \$ 23,001 |

The provision for income taxes differs from the amount computed by applying the statutory federal income tax rate to income before income taxes. The statutory to effective tax rate reconciliation for the years ended December 31 is as follows:

Edgar Filing: S&T BANCORP INC - Form 10-K

| | 2006 | 2005 | 2004 |
|--------------------------------|-----------------|--------------|--------------|
| Statutory tax rate | 35.0% | 35.0% | 35.0% |
| Tax-exempt interest income | (2.8) | (2.3) | (2.2) |
| Dividend exclusion | (0.5) | (0.7) | (0.7) |
| Low income housing tax credits | (1.9) | (1.6) | (1.5) |
| Other | (1.1) | (1.0) | (0.9) |
| Effective tax rate | \$ 28.7% | 29.4% | 29.7% |

Income taxes applicable to security gains were \$1,918,000 in 2006, \$1,753,000 in 2005 and \$1,870,000 in 2004.

PAGE 66

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

Significant components of S&T's temporary differences were as follows at December 31:

| | 2006 | 2005 |
|---|-----------------|-----------------|
| <i>(dollars in thousands)</i> | | |
| Deferred tax liabilities: | | |
| Net unrealized holding gains on securities available for sale | \$ (3,796) | \$ (4,939) |
| Prepaid pension in other employee benefits | (5,816) | (3,997) |
| Deferred loan income | (1,949) | (2,476) |
| Purchase accounting | (3,855) | (4,783) |
| Other | (1,232) | (778) |
| Total deferred tax liabilities | (16,648) | (16,973) |
| Deferred tax assets: | | |
| Allowance for loan losses | 12,059 | 13,090 |
| Loan fees | 905 | 1,152 |
| Net adjustment to apply SFAS No. 158 | 1,635 | |
| State taxes NOL carryforwards | 325 | 274 |
| Other | 3,016 | 2,722 |
| Gross deferred tax assets | 17,940 | 17,238 |
| Less: | | |
| Valuation allowance | (325) | (274) |
| Total deferred tax assets | 17,615 | 16,964 |
| Net deferred tax asset (liability) | \$ 967 | \$ (9) |

S&T establishes a valuation allowance when it is more likely than not that S&T will not be able to realize the benefit of the deferred tax assets, i.e., when future deductibility is uncertain. Periodically, the valuation allowance is reviewed and adjusted based on management's assessments of realizable deferred tax assets. Gross deferred tax assets as of December 31, 2006 and 2005 were reduced by a valuation allowance of \$0.3 million, related to state income tax net operating losses generated by certain subsidiaries, as utilization of these losses is not likely. These operating loss carryforwards total \$5.0 million and will expire in the years 2020-2025.

The period change in deferred taxes is recorded both directly to capital and as a part of the income tax expense and can be summarized as follows at December 31:

| | 2006 | 2005 |
|--|-----------------|-------------------|
| <i>(dollars in thousands)</i> | | |
| Deferred tax changes reflected in other comprehensive income | \$ (2,778) | \$ (6,301) |
| Deferred tax changes reflected in federal income tax expense | 1,802 | 999 |
| Net change in deferred taxes | \$ (976) | \$ (5,302) |

NOTE N**Employee Benefits**

Edgar Filing: S&T BANCORP INC - Form 10-K

S&T Bank maintains a defined benefit pension plan (the Plan) covering substantially all employees. The benefits are based on years of service and the employee s compensation for the highest five consecutive years in the last ten years. Contributions are intended to provide for benefits attributed to employee service to date and for those benefits expected to be earned in the future.

PAGE 67

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

The following table summarizes the components of net periodic pension expense for the Plan:

| | 2006 | 2005 | 2004 |
|--|---------------|---------------|---------------|
| <i>(dollars in thousands)</i> | | | |
| Service cost - benefits earned during the period | \$ 1,989 | \$ 1,725 | \$ 1,535 |
| Interest cost on projected benefit obligation | 2,763 | 2,583 | 2,313 |
| Expected return on plan assets | (4,135) | (3,435) | (2,978) |
| Net amortization and deferral | 185 | 43 | 19 |
| Net periodic pension expense | \$ 802 | \$ 916 | \$ 889 |

The following tables summarize the activity in the benefit obligation and Plan assets:

| | 2006 | 2005 |
|--|------------------|------------------|
| <i>(dollars in thousands)</i> | | |
| CHANGE IN PROJECTED BENEFIT OBLIGATION | | |
| Projected benefit obligation at beginning of year | \$ 48,440 | \$ 43,070 |
| Service cost | 1,989 | 1,725 |
| Interest cost | 2,763 | 2,583 |
| Plan participants' contributions | 318 | 294 |
| Actuarial gain | (1,260) | 2,619 |
| Benefits paid | (1,934) | (1,851) |
| Projected benefit obligation at end of year | \$ 50,316 | \$ 48,440 |
| CHANGE IN PLAN ASSETS | | |
| Market value of plan assets at beginning of year | \$ 52,620 | \$ 42,145 |
| Actual return on plan assets | 5,586 | 2,829 |
| Employer contribution | 6,000 | 9,203 |
| Plan participants' contributions | 318 | 294 |
| Benefits paid | (1,934) | (1,851) |
| Market value of plan assets at end of year | \$ 62,590 | \$ 52,620 |

The following table sets forth the Plan's funded status and the accrued pension cost in the consolidated balance sheets at December 31:

| | 2006 | 2005 |
|--|------------------|------------------|
| <i>(dollars in thousands)</i> | | |
| Projected benefit obligation at end of year | \$ (50,316) | \$ (48,440) |
| Market value of plan assets at end of year | 62,590 | 52,620 |
| Funded status | 12,274 | 4,180 |
| Unrecognized net loss | 4,225 | 7,105 |
| Unamortized prior service cost | 118 | 134 |
| Prepaid pension cost included in other assets | \$ 16,617 | \$ 11,419 |

Edgar Filing: S&T BANCORP INC - Form 10-K

On December 31, 2006, S&T adopted the recognition and disclosure provisions of SFAS No. 158. SFAS No. 158 requires an employer to recognize the funded status of any defined benefit pension plan or postretirement benefit plan in the December 31, 2006 statement of financial position, with a corresponding adjustment to accumulated other comprehensive income, net of tax. For the Plan, the adjustment to accumulated other comprehensive income at adoption represents the net unrecognized

PAGE 68

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

actuarial loss and unamortized prior service cost which were previously netted against the plan's funded status in S&T's statement of financial position pursuant to the provisions of SFAS No. 87. These amounts will be subsequently recognized as net periodic pension cost pursuant to S&T's historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic pension cost in the same periods will be recognized as a component of other comprehensive income. Those amounts will be subsequently recognized as a component of net periodic pension cost on the same basis as the amounts recognized in accumulated other comprehensive income upon adoption of SFAS No. 158.

The incremental effect of adopting the provisions of SFAS No. 158 on S&T's statement of financial position at December 31, 2006 is presented in the following table. The adoption of SFAS No. 158 had no effect on S&T's consolidated statement of income for the year ended December 31, 2006, or for any prior periods presented, and will not effect S&T's operating results in future periods.

| RETIREMENT PLAN OF S&T BANK | 2006 |
|--|------------------|
| <i>(dollars in thousands)</i> | |
| Amounts Recognized in the Statement of Financial Position and in Retained Earnings Consist of: | |
| Prior to adoption of SFAS No. 158: | |
| Prepaid benefit cost | \$ 16,617 |
| Accrued benefit liability | |
| Intangible asset | |
| Accumulated other comprehensive income | |
| Net amount recognized in retained earnings | \$ 16,617 |
| After adoption of SFAS No. 158: | |
| Net amount recognized in statement of financial position | \$ 12,274 |
| Amounts recognized in accumulated other comprehensive income consist of: | |
| Prior service cost | \$ 118 |
| Net actuarial loss | 4,225 |
| Total (before tax effects) | \$ 4,343 |
| Change in accumulated other comprehensive income due to adoption of SFAS No. 158 (before tax effects) | \$ 4,343 |

Included in accumulated other comprehensive income at December 31, 2006 are the following amounts that have not yet been recognized in net periodic pension cost: unrecognized prior service costs of \$118,000 (\$77,000, net of tax) and unrecognized actuarial losses of \$4,225,000 (\$2,746,000, net of tax). The prior service cost and actuarial loss included in accumulated other comprehensive income and expected to be recognized in net periodic pension cost during the year ended December 31, 2007 is \$16,000 (\$10,000, net of tax) and \$0, respectively.

The accumulated benefit obligation for the Plan was \$43,049,000 at December 31, 2006 and \$41,370,000 at December 31, 2005.

Below are actuarial assumptions used in accounting for the Plan at December 31:

| | 2006 | 2005 | 2004 |
|--|-------------|-------------|-------------|
| Weighted-average discount rate | 5.75% | 6.00% | 6.00% |
| Rate of increase in future compensation levels | 4.00% | 4.00% | 4.00% |
| Expected long-term rate of return on plan assets | 8.00% | 8.00% | 8.00% |

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

S&T considers many factors when setting the assumed rate of return on Plan assets. As a general guideline the assumed rate of return is equal to the weighted average of the expected returns for each asset category and is estimated based on historical returns as well as expected future returns.

The Plan's weighted-average asset allocations by asset category are as follows:

| Asset Category | Plan Assets at December 31 | |
|-------------------|----------------------------|-------------|
| | 2006 | 2005 |
| Equity Securities | 55% | 59% |
| Debt Securities | 33% | 26% |
| Other | 12% | 15% |
| Total | 100% | 100% |

S&T Bank's Retirement Plan Committee determines the investment policy for the Plan. In general, the targeted asset allocation is 50 percent-70 percent equities and 30 percent-50 percent fixed-income. A strategic allocation within each asset class is employed based on the Plan's time horizon, risk tolerances, performance expectations and asset class preferences. Investment managers have discretion to invest in any equity or fixed-income asset class, subject to the securities guidelines of the Plan's Investment Policy Statement.

S&T Bank contributed \$7.2 million to the Plan in 2005 for 2006. S&T Bank also contributed \$6.0 million to the Plan in 2006 for 2007. This contribution comprised the majority of the other asset category (e.g., money market account) at December 31, 2006. Benefit payments, which reflect expected future service, as appropriate, are expected to be paid from the Plan for each of the years 2007-2011 and are \$1,981,000, \$2,107,000, \$2,270,000, \$2,468,000, \$2,663,000, respectively, and \$16,382,000 for the five years thereafter.

S&T also has a supplemental executive retirement plan (SERP) for certain key employees. The SERP is unfunded. The balances of the actuarial present values of projected benefit obligations related to the SERP were \$3,389,000 and \$3,304,000 at December 31, 2006 and 2005, respectively. Accrued pension costs related to the SERP were \$2,835,000 and \$2,904,000 at December 31, 2006 and 2005, respectively. In accordance with SFAS No. 158, \$485,000 before tax was reflected in accumulated other comprehensive income at December 31, 2006 in relation to the SERP. In addition, S&T pays the post-retirement health care for a limited number of retirees. The SFAS No. 158 adjustment of (\$156,000), before tax was reflected in accumulated other comprehensive income at December 31, 2006, in relation to post-retirement medical benefits. Net periodic pension cost related to the SERP was \$340,000, \$317,000 and \$279,000 for the years ended December 31, 2006, 2005 and 2004, respectively. The actuarial assumptions are the same as those used for the Plan.

S&T maintains a Thrift Plan, a qualified defined contribution plan, in which substantially all employees are eligible to participate. S&T makes matching contributions to the Thrift Plan up to 3 percent of participants' eligible compensation and may make additional profit-sharing contributions as provided by the Thrift Plan. Expense related to these contributions amounted to \$1,452,000, \$1,963,000 and \$1,428,000 in 2006, 2005 and 2004, respectively.

NOTE O**Incentive and Restricted Stock Plan and Dividend Reinvestment Plan**

S&T adopted an Incentive Stock Plan in 1992 (1992 Stock Plan) that provides for granting incentive stock options, nonstatutory stock options, restricted stock and appreciation rights. On October 17, 1994, the 1992 Stock Plan was amended to include outside directors. The 1992 Stock Plan covers a maximum of 3.2 million shares of S&T common stock and expires ten years from the date of board

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

approval. At December 31, 2002, 3,180,822 nonstatutory stock options and 35,600 restricted stock awards had been granted under the 1992 Stock Plan. No further awards will be made under the 1992 Stock Plan.

S&T adopted the 2003 Stock Plan in 2003 that provides for granting incentive stock options, nonstatutory stock options, restricted stock and appreciation rights. The 2003 Stock Plan covers a maximum of 1.5 million shares of S&T common stock and expires ten years from the date of board approval. The 2003 Stock Plan is similar to the 1992 Stock Plan, which the 2003 Stock Plan replaced. As of December 31, 2006, 937,500 nonstatutory stock options have been granted under the 2003 Stock Plan and 642,750 are currently exercisable.

S&T granted nonstatutory stock options in 2006 under the 2003 Stock Plan at an exercise price determined by the S&T Bancorp, Inc. Board of Directors Compensation Benefits Committee on the date of grant. S&T granted nonstatutory stock options in 2005 under the 2003 Stock Plan at an exercise price equal to the market value of S&T common stock on the date of grant. Nonstatutory stock options granted in 2006 and 2005 have a four-year vesting period and a ten-year life, with 25 percent vesting each year on January 1 of the succeeding year. Stock options granted in 2004 under the 2003 Stock Plan and have a ten-year life. There were 4,000 shares of nonstatutory stock options issued in 2006 and 202,500 shares of nonstatutory stock options issued in 2005 at a price of \$37.86. The total compensation expense related to the 2006 grant will approximate \$19,000, net of tax over the next three years. The total compensation expense related to the 2005 grant will approximate \$857,000 net of tax over the next three years.

During 2006, total proceeds from the 122,200 shares of nonstatutory stock options exercised totaled \$2,755,000 and resulted in a tax benefit of \$502,000. During 2005, total proceeds for the 330,735 shares exercised totaled \$7,906,000 and resulted in a tax benefit of \$1,660,000. During 2004, total proceeds for the 490,525 shares exercised totaled \$10,347,000 and resulted in a tax benefit of \$2,098,000.

Below is activity for nonstatutory stock options for the years ending December 31:

| | 2006 | | 2005 | | 2004 | |
|---|------------------|-------------------------------|------------------|-------------------------------|------------------|-------------------------------|
| | Number of Shares | Weighted Average Option Price | Number of Shares | Weighted Average Option Price | Number of Shares | Weighted Average Option Price |
| Outstanding at beginning of year | 1,775,762 | \$ 29.05 | 1,919,697 | \$ 27.25 | 2,041,572 | \$ 26.34 |
| Granted | 4,000 | 37.86 | 202,500 | 37.86 | 380,700 | 37.08 |
| Exercised | (122,200) | 22.54 | (330,735) | 23.90 | (490,525) | 21.09 |
| Forfeited | (7,200) | 35.04 | (15,700) | 30.81 | (12,050) | 28.13 |
| Outstanding at end of year | 1,650,362 | 29.52 | 1,775,762 | 29.05 | 1,919,697 | 27.25 |
| Exercisable at end of year | 1,443,862 | \$ 28.33 | 1,422,312 | \$ 27.70 | 1,110,922 | \$ 23.08 |

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued**

The following table summarizes the total shares outstanding and the range and weighted average of exercise prices and remaining contractual lives at December 31:

| | 2006 | | | 2005 | | | 2004 | | |
|--------------|--------------------|-----------------|------------------------------------|--------------------|-----------------|------------------------------------|--------------------|-----------------|------------------------------------|
| | Shares Outstanding | Exercise Price | Contractual Remaining Life (Years) | Shares Outstanding | Exercise Price | Contractual Remaining Life (Years) | Shares Outstanding | Exercise Price | Contractual Remaining Life (Years) |
| 1995 | | \$ | | | \$ | | 23,000 | \$ 13.13 | 1 |
| 1996 | | | | 25,500 | 15.44 | 1 | 62,500 | 15.44 | 2 |
| 1997 | 87,462 | 20.38 | 1 | 113,062 | 20.38 | 2 | 143,822 | 20.38 | 3 |
| 1998 | 145,900 | 27.75 | 2 | 162,700 | 27.75 | 3 | 217,300 | 27.75 | 4 |
| 1999 | 123,100 | 22.88 | 3 | 128,900 | 22.88 | 4 | 152,600 | 22.88 | 5 |
| 2000 | 137,300 | 19.81 | 4 | 147,800 | 19.81 | 5 | 163,500 | 19.81 | 6 |
| 2001 | 202,700 | 24.40 | 5 | 219,600 | 24.40 | 6 | 266,525 | 24.40 | 7 |
| 2002 | 104,650 | 26.60 | 6 | 110,500 | 26.60 | 7 | 163,350 | 26.60 | 8 |
| 2003 | 284,550 | 29.97 | 7 | 300,800 | 29.97 | 8 | 346,400 | 29.97 | 9 |
| 2004 | 358,200 | 37.08 | 8 | 364,400 | 37.08 | 9 | 380,700 | 37.08 | 10 |
| 2005 | 202,500 | 37.86 | 9 | 202,500 | 37.86 | 10 | | | |
| 2006 | 4,000 | 37.86 | 9 | | | | | | |
| Total | 1,650,362 | \$ 29.52 | 5.9 | 1,775,762 | \$ 29.05 | 6.6 | 1,919,697 | \$ 27.25 | 6.9 |

The weighted-average remaining contractual term of shares currently exercisable at December 31, 2006 is 5.4 years.

S&T also maintains a Cash Appreciation Rights (CARs) plan under which CARs are granted. CARs are rights to appreciation of the market value of S&T's common stock over the exercise price as of the date of grant. The CARs are settled in cash. There were no CARs granted in 2006 and 2004. CARs granted in 2005 have a four-year vesting period and a ten-year life, with 25 percent vesting each year on January 1 of the succeeding year. There were CARs with respect to 206,900 shares of S&T common stock issued in 2005 at a price of \$37.86. During 2006, CARs with respect to 7,200 shares have been forfeited. The total compensation expense related to the 2005 grant will approximate \$633,000, net of tax over the next three years.

As of December 31, 2006, there were 8,900 shares of unvested restricted stock awards granted related to a previous grant. There were no restricted stock awards granted in 2006 and 2005. These shares vest 25 percent per year with the first vesting, which occurred on January 1, 2004. During the restricted period, the recipient receives dividends and can vote the shares. Generally, if the recipient leaves S&T before the end of the restricted period, the shares will be forfeited. Compensation expense for the restricted stock is ratably recognized over the period of service, generally the restricted period, based on the market value of the stock on the date of grant. As of December 31, 2006 there were 8,900 shares of restricted stock remaining to vest on January 1, 2007.

S&T also sponsors a dividend reinvestment plan (Dividend Plan) whereby shareholders may purchase shares of S&T common stock at market value with reinvested dividends and voluntary cash contributions. American Stock Transfer and Trust Company, the plan administrator and transfer agent, purchases the shares on the open market to fulfill the Dividend Plan's needs.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued****NOTE P****S&T Bancorp, Inc. (parent company only)****Condensed Financial Information**

| BALANCE SHEETS AT DECEMBER 31: | 2006 | 2005 |
|---|-------------------|-------------------|
| <i>(dollars in thousands)</i> | | |
| ASSETS | | |
| Cash | \$ 83 | \$ 54 |
| Investments in: | | |
| Bank subsidiary | 295,780 | 308,732 |
| Nonbank subsidiaries | 36,678 | 33,384 |
| Other assets | 17,490 | 17,864 |
| Total Assets | \$ 350,031 | \$ 360,034 |
| LIABILITIES | | |
| Dividends payable | \$ 7,615 | \$ 7,613 |
| Other liabilities | 3,365 | |
| Total Liabilities | 10,980 | 7,613 |
| Total Shareholders' Equity | 339,051 | 352,421 |
| Total Liabilities and Shareholders' Equity | \$ 350,031 | \$ 360,034 |

| STATEMENTS OF INCOME FOR THE YEAR ENDED DECEMBER 31: | 2006 | 2005 | 2004 |
|---|------------------|------------------|------------------|
| <i>(dollars in thousands)</i> | | | |
| Dividends from subsidiaries | \$ 63,745 | \$ 44,733 | \$ 34,025 |
| Investment income | 67 | 16 | 29 |
| Other Expenses | 818 | 802 | 774 |
| Income before equity in undistributed net income of subsidiaries | 62,994 | 43,947 | 33,280 |
| (Distribution in excess of net income) equity in undistributed net income of: | | | |
| Bank subsidiary | (13,448) | 9,899 | 15,195 |
| Nonbank subsidiaries | 3,790 | 4,397 | 5,883 |
| Net Income | \$ 53,336 | \$ 58,243 | \$ 54,358 |

| STATEMENTS OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31: | 2006 | 2005 | 2004 |
|---|-----------------|-----------------|-----------------|
| <i>(dollars in thousands)</i> | | | |
| OPERATING ACTIVITIES | | | |
| Net Income | \$ 53,336 | \$ 58,243 | \$ 54,358 |
| Equity in undistributed net income of subsidiaries | 9,658 | (14,296) | (21,078) |
| Tax benefit from nonstatutory stock options exercised | 1,049 | 1,795 | 2,098 |
| Other | (1,748) | (1,137) | (1,664) |
| Total Provided by Operating Activities | 62,295 | 44,605 | 33,714 |
| FINANCING ACTIVITIES | | | |
| Dividends | (30,046) | (29,342) | (28,101) |
| Net treasury stock activity | (32,514) | (15,269) | (5,620) |
| Excess tax benefits from stock-based compensation | 294 | | |
| Total Used by Financing Activities | (62,266) | (44,611) | (33,721) |
| Increase (decrease) in Cash | 29 | (6) | (7) |

Edgar Filing: S&T BANCORP INC - Form 10-K

| | | | |
|----------------------------|--------------|--------------|--------------|
| Cash at Beginning of Year | 54 | 60 | 67 |
| Cash at End of Year | \$ 83 | \$ 54 | \$ 60 |

PAGE 73

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued****NOTE Q****Regulatory Matters**

S&T is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet the minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on S&T's financial statements. Under capital guidelines and the regulatory framework for prompt corrective action, S&T must meet specific capital guidelines that involve quantitative measures of S&T's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. S&T's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require S&T to maintain minimum amounts and ratios of Tier 1 and Total capital to risk-weighted assets and Tier 1 capital to average assets. As of December 31, 2006 and 2005, S&T meets all capital adequacy requirements to which it is subject.

To be classified as well capitalized, S&T must maintain minimum Tier 1 risk-based, Total risk-based and Tier 1 leverage ratios as set forth in the table below:

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|--------------------------------|------------|--------|-------------------------------|-------|--|--------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| <i>(dollars in thousands)</i> | | | | | | |
| As of December 31, 2006 | | | | | | |
| Total Capital | \$ 347,487 | 11.93% | \$ 233,085 | 8.00% | \$ 291,356 | 10.00% |
| (to Risk Weighted Assets) | | | | | | |
| Tier 1 Capital | 282,030 | 9.68% | 116,543 | 4.00% | 174,814 | 6.00% |
| (to Risk Weighted Assets) | | | | | | |
| Tier 1 Capital | 282,030 | 8.84% | 95,755 | 3.00% | 159,591 | 5.00% |
| (to Average Assets) | | | | | | |
| As of December 31, 2005 | | | | | | |
| Total Capital | \$ 333,945 | 12.09% | \$ 220,973 | 8.00% | \$ 276,216 | 10.00% |
| (to Risk Weighted Assets) | | | | | | |
| Tier 1 Capital | 290,531 | 10.52% | 110,486 | 4.00% | 165,729 | 6.00% |
| (to Risk Weighted Assets) | | | | | | |
| Tier 1 Capital | 290,531 | 9.50% | 91,766 | 3.00% | 152,943 | 5.00% |
| (to Average Assets) | | | | | | |

Edgar Filing: S&T BANCORP INC - Form 10-K

The most recent notifications from the Federal Reserve Bank and the FDIC categorized S&T and S&T Bank, respectively, as well capitalized under the regulatory framework for corrective action. There have been no conditions or events that management believes have changed S&T or S&T Bank's ranking during 2006 and 2005.

At December 31, 2006, S&T Bank's Tier 1 and Total capital ratios were 8.54 percent and 10.64 percent, respectively, and Tier 1 capital to average assets was 7.74 percent. At December 31, 2005, S&T Bank's Tier 1 and Total capital ratios were 9.57 percent and 10.89 percent, respectively, and Tier 1 capital to average assets was 8.61 percent.

PAGE 74

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued****NOTE R****Selected Financial Data**

(unaudited)

| | 2006 | | | | 2005 | | | |
|--|-------------------|------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|
| | Fourth Quarter | Third Quarter | Second Quarter | First Quarter | Fourth Quarter | Third Quarter | Second Quarter | First Quarter |
| <i>(dollars in thousands, except per share data)</i> | | | | | | | | |
| SUMMARY OF OPERATIONS | | | | | | | | |
| Income Statements: | | | | | | | | |
| Interest income | \$ 52,833 | \$ 53,028 | \$ 50,957 | \$ 47,884 | \$ 46,476 | \$ 44,035 | \$ 42,145 | \$ 39,466 |
| Interest expense | 24,758 | 24,186 | 22,830 | 19,810 | 17,991 | 15,595 | 13,780 | 12,148 |
| Provision for loan losses | 828 | 1,352 | 5,700 | 1,500 | 1,500 | 3,000 | (300) | 800 |
| Net interest income after provision for loan losses | 27,247 | 27,490 | 22,427 | 26,574 | 26,985 | 25,440 | 28,665 | 26,518 |
| Security gains, net | 1,218 | 1,210 | 1,244 | 1,809 | 1,239 | 1,300 | 801 | 1,668 |
| Noninterest income | 8,434 | 8,711 | 9,090 | 8,674 | 8,462 | 8,107 | 8,385 | 7,423 |
| Noninterest expense | 18,727 | 16,339 | 17,273 | 16,939 | 16,237 | 14,662 | 15,486 | 16,078 |
| Income before taxes | 18,172 | 21,072 | 15,488 | 20,118 | 20,449 | 20,185 | 22,365 | 19,531 |
| Applicable income taxes | 4,973 | 6,408 | 4,251 | 5,881 | 5,886 | 5,818 | 6,872 | 5,711 |
| Net income | \$ 13,199 | \$ 14,664 | \$ 11,237 | \$ 14,237 | \$ 14,563 | \$ 14,367 | \$ 15,493 | \$ 13,820 |
| PER SHARE DATA | | | | | | | | |
| Net income-Diluted | \$ 0.52 | \$ 0.57 | \$ 0.43 | \$ 0.54 | \$ 0.55 | \$ 0.54 | \$ 0.58 | \$ 0.51 |
| Dividends declared | 0.30 | 0.29 | 0.29 | 0.29 | 0.29 | 0.28 | 0.28 | 0.28 |
| Book value | 13.37 | 13.24 | 13.14 | 13.41 | 13.41 | 13.35 | 13.09 | 13.06 |
| AVERAGE BALANCE SHEET TOTALS | | | | | | | | |
| Total assets | \$ 3,270,151 | \$ 3,285,807 | \$ 3,282,972 | \$ 3,205,843 | \$ 3,141,728 | \$ 3,090,488 | \$ 3,061,157 | \$ 2,998,237 |
| Securities | 428,556 | 453,128 | 469,472 | 485,935 | 495,676 | 504,806 | 516,704 | 518,872 |
| Net loans | 2,585,787 | 2,579,072 | 2,563,889 | 2,476,748 | 2,415,587 | 2,346,862 | 2,317,945 | 2,259,300 |
| Total deposits | 2,572,123 | 2,518,761 | 2,494,841 | 2,424,946 | 2,348,991 | 2,269,085 | 2,188,288 | 2,157,201 |
| Securities sold under repurchase agreements and federal funds purchased | 99,661 | 104,441 | 116,497 | 138,111 | 162,718 | 141,494 | 127,901 | 96,687 |
| Short-term borrowings | 21,685 | 86,359 | 117,637 | 128,889 | 146,957 | 197,337 | 282,912 | 262,000 |
| Long-term borrowings | 163,161 | 182,790 | 161,422 | 108,817 | 83,813 | 82,174 | 68,352 | 79,248 |
| Subordinated debt | 25,000 | 2,717 | | | | | | |
| Total shareholders' equity | 342,303 | 343,176 | 346,351 | 356,341 | 353,373 | 351,432 | 348,871 | 353,472 |

Table of Contents

REPORT OF MANAGEMENT

S&T Bancorp, Inc. and Subsidiaries

S&T Bancorp, Inc. is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements and notes included in this annual report have been prepared in conformity with United States generally accepted accounting principles and necessarily include some amounts that are based on management's best estimates and judgments.

We, as management of S&T Bancorp, Inc., are responsible for establishing and maintaining effective adequate control over financial reporting that is designed to produce reliable financial statements in conformity with United States generally accepted accounting principles. The system of internal control over financial reporting as it relates to the financial statements is evaluated for effectiveness by management and tested for reliability through a program of internal audits. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

The Audit Committee, consisting entirely of independent directors, meets regularly with management, internal auditors and the independent registered public accounting firm, and reviews audit plans and results, as well as management's actions taken in discharging responsibilities for accounting, financial reporting, and internal control. Ernst & Young LLP, independent registered public accounting firm, and the internal auditors have direct and confidential access to the Audit Committee at all times to discuss the results of their examinations.

REPORT ON MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING

Management assessed the corporation's system of internal control over financial reporting as of December 31, 2006, in relation to criteria for effective internal control over financial reporting as described in Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concludes that, as of December 31, 2006, its system of internal control over financial reporting is effective and meets the criteria of the Internal Control - Integrated Framework. Ernst & Young LLP, independent registered public accounting firm, has issued an attestation report on management's assessment of the Corporation's internal control over financial reporting.

/s/ James C. Miller

James C. Miller,
Chairman and Chief
Executive Officer

Indiana, Pennsylvania
February 23, 2007

/s/ Robert E. Rout

Robert E. Rout
Senior Executive Vice President,
Chief Financial Officer and Secretary

Table of Contents

REPORT OF ERNST & YOUNG LLP, INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING

S&T Bancorp, Inc. and Subsidiaries

Audit Committee of the Board of Directors

S&T Bancorp, Inc.

We have audited management's assessment, included in the accompanying Report on Management's Assessment of Internal Control Over Financial Reporting, that S&T Bancorp, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). S&T 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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company'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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and 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. Because management's assessment and our audit were conducted to also meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management's assessment and our audit of S&T Bancorp, Inc.'s internal control over financial reporting included controls over the preparation of financial statements in accordance with the instructions for the preparation of Consolidated Financial Statements for Bank Holding Companies (Form FRY-9C). 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, management's assessment that S&T Bancorp, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, S&T Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of S&T Bancorp, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006, of S&T Bancorp, Inc. and our report dated February 23, 2007, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Pittsburgh, Pennsylvania

February 23, 2007

PAGE 77

Table of Contents

REPORT OF ERNST & YOUNG LLP, INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON CONSOLIDATED FINANCIAL STATEMENTS

S&T Bancorp, Inc. and Subsidiaries

The Audit Committee of the Board of Directors

S&T Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of S&T Bancorp, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of S&T's management. Our responsibility is to express an opinion on these 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of S&T Bancorp, Inc. and subsidiaries at December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note A to the consolidated financial statements, in 2006 the Company changed its method for the recognition of stock-based compensation expense in accordance with Financial Accounting Standards Board Statement 123(R), *Share Based Payment*. Also, as discussed in Note A to the consolidated financial statements, the Company changed its method of accounting for its defined benefit pension and postretirement plans as of December 31, 2006, in accordance with Financial Accounting Standards Board Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of S&T Bancorp, Inc.'s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 23, 2007, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Pittsburgh, Pennsylvania

February 23, 2007

Table of Contents

Item 9. CHANGES AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None

Item 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of S&T's Chief Executive Officer and Chief Financial Officer (its principal executive officer and principal financial officer) management has evaluated the effectiveness of the design and operation of S&T's disclosure controls and procedures. Based on that evaluation, our CEO and CFO have concluded that our disclosure controls and procedures are effective as of December 31, 2006.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Management assessed the corporation's system of internal control over financial reporting as of December 31, 2006, in relation to criteria for effective internal control over financial reporting as described in Internal Control Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concludes that, as of December 31, 2006, its system of internal control over financial reporting is effective and meets the criteria of the Internal Control Integrated Framework .

Ernst & Young LLP, independent registered public accounting firm, has issued an attestation report on management's assessment of the Corporation's internal control over financial reporting, as stated in their report which is included herein.

Item 9B. OTHER INFORMATION

None

Table of Contents**PART III****Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by Item 10 of Form 10-K is incorporated herein from the sections entitled *Beneficial Ownership of S&T Common Stock by Directors and Officers* and *Executive Officers of the Registrant* in our proxy statement relating to our April 16, 2007, annual meeting of shareholders.

Item 11. EXECUTIVE COMPENSATION

This information required by Item 11 of Form 10-K is incorporated herein from the sections entitled *Director Compensation* and *Remuneration of Executive Officers* in our proxy statement relating to our April 16, 2007, annual meeting of shareholders.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

Except as set forth below the information required by Item 12 of Form 10-K is incorporated from the sections entitled *Principal Beneficial Owners of S&T Common Stock* and *Beneficial Ownership of S&T Common Stock by Directors and Officers* in our proxy statement relating to our April 16, 2007, annual meeting of shareholders.

EQUITY COMPENSATION PLAN INFORMATION

The following table provides information as of December 31, 2006 related to the equity compensation plans in effect at that time.

| Plan category | (a) Number of securities to be issued upon exercise of outstanding options, warrants and rights | (b) Weighted-average exercise price of outstanding options, warrants and rights | (c) Number of securities remaining available for future issuance under equity compensation plan (excluding securities reflected in column (a)) |
|--|--|--|---|
| Equity compensation plan approved by shareholders ¹ | 1,650,362 | \$ 29.52 | 562,500 |
| Equity compensation plans not approved by shareholders | 0 | 0 | 0 |
| Total | 1,650,362 | \$ 29.52 | 562,500 |

(1) Awards granted under the S&T Bancorp, Inc. Amended and Restated 1992 Incentive Stock Plan (the 1992 Plan) and the 2003 Incentive Stock Plan. The 1992 Plan expired in 2002 and no further awards may be granted thereunder.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 of Form 10-K is incorporated herein from the sections entitled "Transactions with Related Parties" and "Compensation Committee Interlocks and Insider Participation" in our proxy statement relating to our April 16, 2007, annual meeting of shareholders.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by Item 14 of Form 10-K is incorporated herein from the section entitled "Independent Registered Public Accounting Firm" in our proxy statement relating to our April 16, 2007, annual meeting of shareholders.

PAGE 80

Table of Contents

PART IV

Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this report.

Consolidated Financial Statements: The following consolidated financial statements are included in Part II, Item 8 of this report. No financial statement schedules are being filed since the required information is inapplicable or is presented in the Consolidated Financial Statements or related Notes.

| | |
|---|----|
| <u>Consolidated Balance Sheets</u> | 45 |
| <u>Consolidated Statements of Income</u> | 46 |
| <u>Consolidated Statements of Changes in Shareholders' Equity</u> | 47 |
| <u>Consolidated Statements of Cash Flows</u> | 48 |
| <u>Notes to Consolidated Financial Statements</u> | 49 |
| <u>Report of Management</u> | 76 |
| <u>Independent Registered Public Accounting Firm</u> | 77 |

Table of Contents

(b) Exhibits

- 3.1 Articles of Incorporation of S&T Bancorp, Inc. Filed as Exhibit B to Registration Statement (No. 2-83565) on Form S-4 of S&T Bancorp, Inc., dated May 5, 1983, and incorporated herein by reference.
- 3.2 Amendment to Articles of Incorporation of S&T Bancorp, Inc. Filed as Exhibit 3.2 to Form S-4 Registration Statement (No. 33-02600) dated January 15, 1986, and incorporated herein by reference.
- 3.3 Amendment to Articles of Incorporation of S&T Bancorp, Inc. effective May 8, 1989, incorporated herein by reference. Filed as exhibit 3.3 to S&T Bancorp, Inc. Annual Report on Form 10-K for year ending December 31, 1998 and incorporated herein by reference.
- 3.4 Amendment to Articles of Incorporation of S&T Bancorp, Inc. effective July 21, 1995. Filed as exhibit 3.4 to S&T Bancorp, Inc. Annual Report on Form 10-K for year ending December 31, 1998 and incorporated here by reference.
- 3.5 Amendment to Articles of Incorporation of S&T Bancorp, Inc. effective June 18, 1998. Filed as exhibit 3.5 to S&T Bancorp, Inc. Annual Report on Form 10-K for year ending December 31, 1998 and incorporated herein by reference.
- 3.6 By-laws of S&T Bancorp, Inc., as amended, December 16, 2002. Filed as Exhibit 3.6 to S&T Bancorp, Inc. Annual Report on Form 10-K for the year ending December 31, 2002 and incorporated herein by reference.
- 10.1 S&T Bancorp, Inc. Amended and Restated 1992 Incentive Stock Plan. Filed as Exhibit 4.2 to Form S-8 Registration Statement (No. 333-48549) dated March 24, 1998 and incorporated herein by reference.*
- 10.2 S&T Bancorp, Inc. 2003 Incentive Stock Plan. Filed as Exhibit 4.2 to Form S-8 Registration Statement (No. 333-111557) dated December 24, 2003 and incorporated herein by reference.*
- 21 Subsidiaries of the Registrant.
- 23 Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
- 24 Power of Attorney.
- 31.1 Rule 13a-14(a) Certification of the Chief Executive Officer.
- 31.2 Rule 13a-14(a) Certification of the Chief Financial Officer.
- 32 Rule 13a-14(b) Certification of the Chief Executive Officer and Chief Financial Officer.

* Management Contract or Compensatory Plan or Arrangement

Table of Contents

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.

S&T BANCORP, INC.

| | | |
|--|--------------|----------|
| | (Registrant) | |
| /s/ James C. Miller | | 02/26/07 |
| James C. Miller, | | Date |
| Chairman and Chief Executive Officer | | |
| /s/ Robert E. Rout | | 02/26/07 |
| Robert E. Rout, | | Date |
| Senior Executive Vice President, Chief Financial | | |
| Officer and Secretary | | |

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.

| SIGNATURE | TITLE | DATE |
|---------------------|---|----------|
| /s/ James C. Miller | Chairman and Chief Executive Officer (Principal Executive Officer) | 02/26/07 |
| James C. Miller | | |
| /s/ Robert E. Rout | Senior Executive Vice President, Chief Financial Officer and Secretary (Principal Financial and Accounting Officer) | 02/26/07 |
| Robert E. Rout | | |
| /s/ Joseph A. Kirk | Director | 02/26/07 |
| Joseph A. Kirk | | |
| | Director | 02/26/07 |
| Thomas A. Brice | | |
| * | Director | 02/26/07 |
| Todd D. Brice | | |
| * | Director | 02/26/07 |
| James L. Carino | | |

Edgar Filing: S&T BANCORP INC - Form 10-K

| | | |
|---------------------|----------|----------|
| | Director | 02/26/07 |
| John J. Delaney | | |
| * | Director | 02/26/07 |
| Michael J. Donnelly | | |

PAGE 83

Table of Contents

| SIGNATURE | TITLE | DATE |
|---|----------|----------|
| * William J. Gatti | Director | 02/26/07 |
| * Ruth M. Grant | Director | 02/26/07 |
| * Jeffrey D. Grube | Director | 02/26/07 |
| * Frank W. Jones | Director | 02/26/07 |
| * Samuel Levy | Director | 02/26/07 |
| * James V. Milano | Director | 02/26/07 |
| Christine J. Olson | Director | 02/26/07 |
| * Alan Papernick | Director | 02/26/07 |
| Myles D. Sampson | Director | 02/26/07 |
| * Charles A. Spadafora | Director | 02/26/07 |
| *By: /s/ Joseph A. Kirk Joseph A. Kirk Attorney-in-fact | Director | 02/26/07 |