

Stock Yards Bancorp, Inc.

Form 10-Q

November 03, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2017

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 1-13661

**STOCK YARDS BANCORP, INC.**

(Exact name of registrant as specified in its charter)

Kentucky 61-1137529  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

1040 East Main Street, Louisville, Kentucky 40206

(Address of principal executive offices including zip code)

(502) 582-2571

---

(Registrant's telephone number, including area code)

Not Applicable

---

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes                      No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).                      Yes                      No

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

<b>Large accelerated filer</b>	<b>Accelerated filer</b>
<b>Non-accelerated filer</b> (Do not check if a smaller reporting Company)	<b>Smaller reporting company</b>
<b>Emerging growth company</b>	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes                      No

The number of shares of the registrant's Common Stock, no par value, outstanding as of October 26, 2017 was 22,670,610.

---

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Index

**Item** **Page**

**PART I – FINANCIAL INFORMATION**

**Item 1. Financial Statements**

The following consolidated financial statements of Stock Yards Bancorp, Inc. and Subsidiary are submitted herewith:

	<u>Consolidated Balance Sheets September 30, 2017 (Unaudited) and December 31, 2016</u>	3
	<u>Consolidated Statements of Income (Unaudited) for the three and nine months ended September 30, 2017 and 2016</u>	4
	<u>Consolidated Statements of Comprehensive Income (Unaudited) for the three and nine months ended September 30, 2017 and 2016</u>	5
	<u>Consolidated Statements of Changes in Stockholders' Equity (Unaudited) for the nine months ended September 30, 2017 and 2016</u>	6
	<u>Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2017 and 2016</u>	7
	<u>Notes to Consolidated Financial Statements (Unaudited)</u>	8
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	43
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	68
Item 4.	<u>Controls and Procedures</u>	69

**PART II – OTHER INFORMATION**

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 69

Item 6. Exhibits 70

1

---

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Index

**PART I – FINANCIAL INFORMATION**

**Glossary of Acronyms and Terms**

The following listing provides a comprehensive reference of common acronyms and terms used throughout the document:

ASU	Accounting Standards Update
Bancorp	Stock Yards Bancorp, Inc.
Bank	Stock Yards Bank & Trust Company
BOLI	Bank Owned Life Insurance
BP	Basis Point = 1/100 <sup>th</sup> of one percent
COSO	Committee of Sponsoring Organizations
CRA	Community Reinvestment Act of 1977
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
EPS	Earnings Per Share
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration
FHLB	Federal Home Loan Bank
FHLMC	Federal Home Loan Mortgage Corporation
FNMA	Federal National Mortgage Association
GNMA	Government National Mortgage Association
WM&T	Wealth Management and Trust Department
LIBOR	London Interbank Offered Rate
MSR	Mortgage Servicing Right
OAEM	Other Assets Especially Mentioned
OREO	Other Real Estate Owned
PSU	Performance Stock Unit
RSU	Restricted Stock Unit
SAR	Stock Appreciation Right
SEC	Securities and Exchange Commission

TDRs	Troubled Debt Restructurings
US GAAP	United States Generally Accepted Accounting Principles
VA	U.S. Department of Veterans Affairs

Table of ContentsItem 1. Financial Statements**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

Consolidated Balance Sheets

September 30, 2017 (unaudited) and December 31, 2016

(In thousands, except share data)

	<b>September 30, 2017</b>	<b>December 31, 2016</b>
<b>Assets</b>		
Cash and due from banks	\$47,700	\$39,709
Federal funds sold and interest bearing deposits	81,378	8,264
Cash and cash equivalents	129,078	47,973
Mortgage loans held for sale	5,459	3,213
Securities available-for-sale (amortized cost of \$571,953 in 2017 and \$571,936 in 2016)	571,522	570,074
Federal Home Loan Bank stock and other securities	7,666	6,347
Loans	2,335,120	2,305,375
Less allowance for loan losses	24,948	24,007
Net loans	2,310,172	2,281,368
Premises and equipment, net	41,498	42,384
Bank owned life insurance	31,854	31,867
Accrued interest receivable	8,162	6,878
Other assets	50,502	49,377
Total assets	\$3,155,913	\$3,039,481
<b>Liabilities and Stockholders' Equity</b>		
Deposits:		
Non-interest bearing	\$676,824	\$680,156
Interest bearing	1,805,142	1,840,392
Total deposits	2,481,966	2,520,548
Securities sold under agreements to repurchase	71,863	67,595
Federal funds purchased and other short-term borrowings	161,961	47,374
Federal Home Loan Bank advances	50,110	51,075
Accrued interest payable	212	144
Other liabilities	55,546	38,873
Total liabilities	2,821,658	2,725,609
Stockholders' equity:		
Preferred stock, no par value. Authorized 1,000,000 shares; no shares issued or outstanding	-	-
Common stock, no par value. Authorized 40,000,000 shares; issued and outstanding 22,669,339 and 22,617,098 shares in 2017 and 2016, respectively	36,424	36,250
Additional paid-in capital	30,681	26,682



Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Retained earnings	267,681	252,439
Accumulated other comprehensive loss	(531 )	(1,499 )
Total stockholders' equity	334,255	313,872
Total liabilities and stockholders' equity	\$3,155,913	\$3,039,481

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**STOCK  
YARDS  
BANCORP,  
INC. AND  
SUBSIDIARY**

Consolidated  
Statements of  
Income  
(Unaudited)  
For the three  
and nine  
months ended  
September 30,  
2017 and 2016  
(In thousands,  
except per share  
data)

	<b>For three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Interest income:				
Loans	\$25,401	\$23,436	\$73,812	\$67,992
Federal funds sold and interest bearing deposits	388	95	798	395
Mortgage loans held for sale	48	66	145	185
Securities – taxable	2,003	2,047	6,173	6,325
Securities – tax-exempt	271	298	829	907
Total interest income	28,111	25,942	81,757	75,804
Interest expense:				
Deposits	1,593	941	4,237	2,916
Federal funds purchased and other short-term borrowing	77	19	125	57
Securities sold under agreements to repurchase	33	38	100	100
Federal Home Loan Bank advances	244	184	715	552
Total interest expense	1,947	1,182	5,177	3,625
Net interest income	26,164	24,760	76,580	72,179
Provision for loan losses	150	1,250	1,650	2,500
Net interest income after provision for loan losses	26,014	23,510	74,930	69,679
Non-interest income:				
Wealth management and trust services	5,025	4,800	15,272	14,219
Service charges on deposit accounts	2,522	2,544	7,368	6,952
Bankcard transactions	1,492	1,455	4,412	4,198
Mortgage banking	781	1,072	2,380	2,896
Gain on call of securities available for sale	31	—	31	—
Securities brokerage	551	558	1,584	1,539
Bank owned life insurance	204	216	964	657
Other	497	713	1,564	1,757

Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Total non-interest income	11,103	11,358	33,575	32,218
Non-interest expenses:				
Salaries and employee benefits	12,983	12,048	39,244	36,214
Net occupancy	1,621	1,646	4,765	4,716
Data processing	1,920	1,747	5,909	5,172
Furniture and equipment	316	277	861	853
FDIC insurance	242	356	716	1,035
Amortization of investments in tax credit partnerships	616	1,015	1,847	3,046
Other	3,619	3,429	10,469	9,215
Total non-interest expenses	21,317	20,518	63,811	60,251
Income before income taxes	15,800	14,350	44,694	41,646
Income tax expense	4,096	3,883	11,597	11,235
Net income	\$11,704	\$10,467	\$33,097	\$30,411
Net income per share:				
Basic	\$0.52	\$0.47	\$1.47	\$1.36
Diluted	\$0.51	\$0.46	\$1.44	\$1.34
Average common shares:				
Basic	22,542	22,385	22,524	22,325
Diluted	22,964	22,803	22,984	22,711

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

Consolidated Statements of Comprehensive Income (Unaudited)  
 For the three and nine months ended September 30, 2017 and 2016  
 (In thousands)

	<b>Three months ended September 30, 2017</b>		<b>Nine months ended September 30, 2017</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Net income	\$11,704	\$10,467	\$33,097	\$30,411
Other comprehensive income, net of tax:				
Unrealized gains (losses) on securities available for sale:				
Unrealized gains (losses) arising during the period, net of tax \$29, (\$616), \$512, and \$2,213, respectively	56	(1,147)	950	4,110
Reclassification adjustment for securities (gains) realized in income (net of tax of \$(11), \$0, \$(11), and \$0, respectively)	(20 )	—	(20 )	—
Unrealized losses on hedging instruments:				
Unrealized gains (losses) arising during the period, net of tax benefit of \$23, \$74, \$21, (\$162), respectively	43	137	38	(301 )
Other comprehensive income (loss), net of tax	79	(1,010)	968	3,809
Comprehensive income	\$11,783	\$9,457	\$34,065	\$34,220

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

For the nine months ended September 30, 2017 and 2016

(In thousands, except per share data)

	<b>Common stock Number of shares</b>	<b>Amount</b>	<b>Additional paid-in capital</b>	<b>Retained earnings</b>	<b>Accumulated other comprehensive income (loss)</b>	<b>Total</b>
Balance December 31, 2015	14,919	\$ 10,616	\$ 44,180	\$ 231,091	\$ 632	\$ 286,519
Net income	-	-	-	30,411	-	30,411
Other comprehensive income, net of tax	-	-	-	-	3,809	3,809
Stock compensation expense	-	-	1,646	-	-	1,646
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	159	527	3,404	(2,903 )	-	1,028
3 for 2 stock split	7,494	24,956	(24,956 )	-	-	-
Cash dividends, \$0.53 per share	-	-	-	(11,843 )	-	(11,843 )
Shares cancelled	(9 )	(31 )	(224 )	255	-	-
Balance September 30, 2016	22,563	\$ 36,068	\$ 24,050	\$ 247,011	\$ 4,441	\$ 311,570
Balance December 31, 2016	22,617	\$ 36,250	\$ 26,682	\$ 252,439	\$ (1,499 )	\$ 313,872
Net income	-	-	-	33,097	-	33,097
Other comprehensive income, net of tax	-	-	-	-	968	968
Stock compensation expense	-	-	2,012	-	-	2,012
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	59	198	2,142	(4,669 )	-	(2,329 )
Cash dividends, \$0.59 per share	-	-	-	(13,365 )	-	(13,365 )
Shares cancelled	(7 )	(24 )	(155 )	179	-	-

Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Balance September 30, 2017	22,669	\$36,424	\$ 30,681	\$267,681	\$ (531	)	\$334,255
----------------------------	--------	----------	-----------	-----------	---------	---	-----------

See accompanying notes to unaudited consolidated financial statements.

6

---

Table of Contents**STOCK  
YARDS  
BANCORP,  
INC. AND  
SUBSIDIARY**

Consolidated  
Statements of  
Cash Flows  
(Unaudited)  
For the nine  
months ended  
September 30,  
2017 and 2016  
(In thousands)

	<b>2017</b>	<b>2016</b>
Operating activities:		
Net income	\$33,097	\$30,411
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,650	2,500
Depreciation, amortization and accretion, net	6,848	8,016
Deferred income tax provision	(1,811 )	(320 )
Gain on call of securities available for sale	(31 )	—
Gain on sales of mortgage loans held for sale	(1,453 )	(1,825 )
Origination of mortgage loans held for sale	(74,857 )	(91,195 )
Proceeds from sale of mortgage loans held for sale	74,064	93,861
Bank owned life insurance income	(964 )	(657 )
Loss on the disposal of premises and equipment	-	163
(Gain) on the sale of foreclosed assets	(39 )	(382 )
Stock compensation expense	2,012	1,646
Excess tax benefits from share-based compensation arrangements	(1,353 )	(963 )
Decrease in accrued interest receivable and other assets	(5,651 )	(6,145 )
Increase in accrued interest payable and other liabilities	18,062	14,253
Net cash provided by operating activities	49,574	49,363
Investing activities:		
Purchases of securities available for sale	(422,190)	(327,711)
Proceeds from sale of securities available for sale	-	-
Proceeds from maturities of securities available for sale	420,179	355,943
Purchase of Federal Home Loan Bank stock	(1,319 )	-
Net increase in loans	(30,454 )	(191,793)
Purchases of premises and equipment	(1,733 )	(5,853 )
Proceeds from mortality benefit of bank owned life insurance	970	-
Proceeds from sale of foreclosed assets	2,432	1,403
Net cash used in investing activities	(32,115 )	(168,011)
Financing activities:		
Net (decrease) increase in deposits	(38,582 )	18,895
Net increase in securities sold under agreements to repurchase and federal funds purchased	118,855	56,699

Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Proceeds from Federal Home Loan Bank advances	90,000	199,000
Repayments of Federal Home Loan Bank advances	(90,965 )	(191,102)
Proceeds (used for) and received from settlement of stock awards	(216 )	1,599
Excess tax benefits from share-based compensation arrangements	-	963
Common stock repurchases	(2,113 )	(1,534 )
Cash dividends paid	(13,333 )	(11,812 )
Net cash provided by financing activities	63,646	72,708
Net increase (decrease) in cash and cash equivalents	81,105	(45,940 )
Cash and cash equivalents at beginning of period	47,973	103,833
Cash and cash equivalents at end of period	\$129,078	\$57,893
Supplemental cash flow information:		
Income tax payments	\$11,063	\$9,190
Cash paid for interest	5,109	3,636
Supplemental non-cash activity:		
Transfers from loans to foreclosed assets	\$-	\$1,522

See accompanying notes to unaudited consolidated financial statements.



Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

**Notes to Consolidated Financial Statements (Unaudited)**

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

The accompanying unaudited consolidated financial statements have been prepared in accordance with instructions to Form 10-Q and do not include all information and footnotes required by U.S. generally accepted accounting principles (US GAAP) for complete financial statements. The consolidated unaudited financial statements of Stock Yards Bancorp, Inc. (“Bancorp”) and its subsidiary reflect all adjustments (consisting only of adjustments of a normal recurring nature) which are, in the opinion of management, necessary for a fair presentation of financial condition and results of operations for the interim periods.

The unaudited consolidated financial statements include the accounts of Stock Yards Bancorp, Inc. and its wholly-owned subsidiary, Stock Yards Bank & Trust Company (“Bank”). Significant inter-company transactions and accounts have been eliminated in consolidation. In preparing the unaudited consolidated financial statements, management is required to make estimates and assumptions that affect reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of related revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to determination of the allowance for loan losses, valuation of available-for sale securities, other real estate owned and income tax assets, and estimated liabilities and expense.

A description of other significant accounting policies is presented in the notes to Consolidated Financial Statements for the year ended December 31, 2016 included in Stock Yards Bancorp, Inc.’s Annual Report on Form 10-K. Certain reclassifications have been made in the prior year financial statements to conform to current year classifications.

Interim results for the three and nine-month periods ended September 30, 2017 are not necessarily indicative of results for the entire year.

**Critical Accounting Policies**

The allowance for loan losses is management's estimate of probable losses inherent in the loan portfolio as of the balance sheet date. Loan losses are charged against the allowance when management believes uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Management has identified the accounting policy related to the allowance and provision for loan losses as critical to the understanding of Bancorp's results of operations and discussed this conclusion with the Audit Committee of the Board of Directors. Since application of this policy requires significant management assumptions and estimates, it could result in materially different amounts to be reported if conditions or underlying circumstances were to change. The provision for loan losses reflects an allowance methodology driven by risk ratings, historical losses, specific loan loss allocations, and qualitative factors. Assumptions include many factors such as changes in borrowers' financial condition which can change quickly or historical loss ratios related to certain loan portfolios which may or may not be indicative of future losses. In the first quarter of 2017, Bancorp extended the historical period used to capture Bancorp's historical loss ratios from 24 quarters to 28 quarters. This extension of the historical period was applied to all classes and segments of the portfolio. The expansion of the look-back period for the historical loss rates used in the quantitative allocation caused management to review the overall methodology for the qualitative factors to ensure Bancorp was appropriately capturing the risk not addressed in the historical loss rates used in the quantitative allocation, resulting in the same expansion of the look-back period for the qualitative factors. Management believes the extension of the look-back period is appropriate to capture the impact of a full economic cycle and more accurately represents the current level of risk inherent in the loan portfolio. To the extent that management's assumptions prove incorrect, results from operations could be materially affected by a higher or lower provision for loan losses. The accounting policy related to the allowance for loan losses is applicable to the commercial banking segment of Bancorp. The impact and any associated risks related to this policy on Bancorp's business operations are discussed in the "Allowance for Loan Losses" section below.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

Bancorp's allowance calculation includes allocations to loan portfolio segments at September 30, 2017 for qualitative factors including, among other factors, local economic and business conditions in each of our primary markets, quality and experience of lending staff and management, exceptions to lending policies, levels of and trends in past due loans and loan classifications, concentrations of credit such as collateral type, trends in portfolio growth, changes in value of underlying collateral for collateral-dependent loans, effect of other external factors such as the national economic and business trends, quality and depth of the loan review function, and management's judgement of current trends and potential risks. Bancorp utilizes the sum of all allowance amounts derived as described above as the appropriate level of allowance for loan and lease losses. Changes in criteria used in this evaluation or availability of new information could cause the allowance to be increased or decreased in future periods. In addition, bank regulatory agencies, as part of their examination process, may require adjustments to the allowance for loan losses based on their judgments and estimates.

**(2) Securities**

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

(in thousands)	<b>Amortized</b>	<b>Unrealized</b>		<b>Fair</b>
<b>September 30, 2017</b>	<b>cost</b>	<b>Gains</b>	<b>Losses</b>	<b>value</b>
Government sponsored enterprise obligations	\$ 372,596	\$ 846	\$ 778	\$ 372,664
Mortgage-backed securities - government agencies	147,604	697	1,581	146,720
Obligations of states and political subdivisions	51,100	611	89	51,622
Corporate equity securities	653	-	137	516
<b>Total securities available for sale</b>	<b>\$ 571,953</b>	<b>\$ 2,154</b>	<b>\$ 2,585</b>	<b>\$ 571,522</b>
<b>December 31, 2016</b>				
U.S. Treasury and other U.S. Government obligations	\$ 74,997	\$ 1	\$ -	\$ 74,998
Government sponsored enterprise obligations	268,784	800	1,494	268,090
Mortgage-backed securities - government agencies	170,344	735	2,236	168,843
Obligations of states and political subdivisions	57,158	682	396	57,444
Corporate equity securities	653	46	-	699
<b>Total securities available for sale</b>	<b>\$ 571,936</b>	<b>\$ 2,264</b>	<b>\$ 4,126</b>	<b>\$ 570,074</b>

Corporate equity securities consist of common stock in a publicly-traded business development company.

There were no securities classified as held to maturity as of September 30, 2017 or December 31, 2016.

9

---

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

Bancorp sold no securities during the three or nine month periods ending September 30, 2016 or 2017. One security was called prior to maturity in the third quarter of 2017 resulting in the receipt of a pre-payment penalty. The penalty income was classified as a realized gain on the call of available for sale securities.

A summary of the available-for-sale investment securities by contractual maturity groupings as of September 30, 2017 is shown below.

(in thousands)

<b>Securities available-for-sale</b>	<b>Amortized cost</b>	<b>Fair value</b>
Due within 1 year	\$ 216,651	\$216,696
Due after 1 but within 5 years	74,383	74,529
Due after 5 but within 10 years	14,085	14,031
Due after 10 years	118,577	119,030
Mortgage-backed securities - government agencies	147,604	146,720
Corporate equity securities	653	516
<b>Total securities available-for-sale</b>	<b>\$ 571,953</b>	<b>\$571,522</b>

Actual maturities may differ from contractual maturities because some issuers have the right to call or prepay obligations. In addition to equity securities, the investment portfolio includes agency mortgage-backed securities, which are guaranteed by agencies such as the FHLMC, FNMA, and GNMA. These securities differ from traditional debt securities primarily in that they may have uncertain principal payment dates and are priced based on estimated prepayment rates on underlying collateral.

Bancorp pledges portions of its investment securities portfolio to secure public fund deposits, cash balances of certain wealth management and trust accounts, and securities sold under agreements to repurchase. The carrying value of these pledged securities was approximately \$329.7 million at September 30, 2017 and \$380.4 million at December 31, 2016.



Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

Securities with unrealized losses at September 30, 2017 and December 31, 2016, not recognized in the statements of income are as follows:

(in thousands)	<b>Less than 12 months</b>		<b>12 months or more</b>		<b>Total</b>	
	<b>Fair</b>	<b>Unrealized</b>	<b>Fair</b>	<b>Unrealized</b>	<b>Fair</b>	<b>Unrealized</b>
<b>September 30, 2017</b>	<b>value</b>	<b>losses</b>	<b>value</b>	<b>losses</b>	<b>value</b>	<b>losses</b>
Government sponsored enterprise obligations	\$ 190,462	\$ 135	\$ 70,176	\$ 643	\$ 260,638	\$ 778
Mortgage-backed securities - government agencies	13,227	117	65,781	1,464	79,008	1,581
Obligations of states and political subdivisions	9,307	13	6,287	76	15,594	89
Corporate equity securities	516	137	-	-	516	137
<b>Total temporarily impaired securities</b>	<b>\$ 213,512</b>	<b>\$ 402</b>	<b>\$ 142,244</b>	<b>\$ 2,183</b>	<b>\$ 355,756</b>	<b>\$ 2,585</b>
<b>December 31, 2016</b>						
Government sponsored enterprise obligations	\$ 154,951	\$ 1,344	\$ 3,485	\$ 150	\$ 158,436	\$ 1,494
Mortgage-backed securities - government agencies	115,374	1,873	9,914	363	125,288	2,236
Obligations of states and political subdivisions	29,893	380	1,478	16	31,371	396
<b>Total temporarily impaired securities</b>	<b>\$ 300,218</b>	<b>\$ 3,597</b>	<b>\$ 14,877</b>	<b>\$ 529</b>	<b>\$ 315,095</b>	<b>\$ 4,126</b>

Applicable dates for determining when securities are in an unrealized loss position are September 30, 2017 and December 31, 2016. As such, it is possible that a security had a market value lower than its amortized cost on other days during the past twelve months, but is not in the “investments with an unrealized loss of less than 12 months” category above.

Unrealized losses on Bancorp’s investment securities portfolio have not been recognized as an expense because the securities are of high credit quality, and the decline in fair values is due to changes in the prevailing interest rate environment since the purchase date. Fair value is expected to recover as securities reach their maturity date and/or the interest rate environment returns to conditions similar to when these securities were purchased. Because management does not intend to sell the investments, and it is not likely that Bancorp will be required to sell the investments before

recovery of their amortized cost bases, which may be maturity, Bancorp does not consider these securities to be other-than-temporarily impaired at September 30, 2017.

FHLB stock and other securities are investments held by Bancorp which are not readily marketable and are carried at cost. This category includes Federal Home Loan Bank of Cincinnati (FHLB) stock which is required for access to FHLB borrowing.



Table of Contents**Stock Yards Bancorp, inc. and subsidiary****(3) Loans**

Composition of loans, net of deferred fees and costs, by primary loan portfolio class follows:

(in thousands)	<b>September 30, 2017</b>	<b>December 31, 2016</b>
Commercial and industrial	\$750,728	\$736,841
Construction and development, excluding undeveloped land	174,310	192,348
Undeveloped land	20,989	21,496
Real estate mortgage:		
Commercial investment	576,810	538,886
Owner occupied commercial	397,804	408,292
1-4 family residential	261,707	249,498
Home equity - first lien	51,925	55,325
Home equity - junior lien	63,416	67,519
Subtotal: Real estate mortgage	1,351,662	1,319,520
Consumer	37,431	35,170
Total loans	\$2,335,120	\$2,305,375

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

The following table presents the balance of the recorded investment in loans and allowance for loan losses by portfolio segment and based on impairment evaluation method as of September 30, 2017 and December 31, 2016.

(in thousands)	<b>Type of loan</b>						
	<b>Commercial and industrial</b>		<b>Construction and development excluding undeveloped land</b>	<b>Undeveloped land</b>	<b>Real estate mortgage</b>	<b>Consumer</b>	<b>Total</b>
<b><u>September 30, 2017</u></b>							
<b>Loans</b>	\$750,728	\$ 174,310	\$ 20,989	\$ 1,351,662	\$ 37,431	\$ 2,335,120	
Loans collectively evaluated for impairment	\$748,591	\$ 173,573	\$ 20,515	\$ 1,348,774	\$ 37,375	\$ 2,328,828	
Loans individually evaluated for impairment	\$2,137	\$ 737	\$ 474	\$ 2,403	\$ 56	\$ 5,807	
Loans acquired with deteriorated credit quality	\$-	\$ -	\$ -	\$ 485	\$ -	\$ 485	
<b>Allowance for loan losses</b>							
At December 31, 2016	\$ 10,483	\$ 1,923	\$ 684	\$ 10,573	\$ 344	\$ 24,007	
Provision (credit)	1,518	9	(85 )	54	154	1,650	
Charge-offs	(770 )	-	-	(45 )	(418 )	(1,233 )	
Recoveries	128	-	-	98	298	524	
At September 30, 2017	\$ 11,359	\$ 1,932	\$ 599	\$ 10,680	\$ 378	\$ 24,948	
Allowance for loans collectively evaluated for impairment	\$ 10,705	\$ 1,932	\$ 599	\$ 10,668	\$ 322	\$ 24,226	

Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Allowance for loans individually evaluated for impairment	\$ 654	\$ -	\$ -	\$ 12	\$ 56	\$ 722
Allowance for loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

(in thousands)	<b>Type of loan</b>					
	<b>Construction and development</b>			<b>Commercial including undeveloped</b>		<b>Real estate</b>
<b>December 31, 2016</b>	<b>industrial</b>	<b>land</b>	<b>land</b>	<b>mortgage</b>	<b>Consumer</b>	<b>Total</b>
<b>Loans</b>	\$736,841	\$ 192,348	\$ 21,496	\$ 1,319,520	\$ 35,170	\$ 2,305,375
Loans collectively evaluated for impairment	\$734,139	\$ 191,810	\$ 21,022	\$ 1,316,400	\$ 35,111	\$ 2,298,482
Loans individually evaluated for impairment	\$2,682	\$ 538	\$ 474	\$ 2,516	\$ 59	\$ 6,269
Loans acquired with deteriorated credit quality	\$20	\$ -	\$ -	\$ 604	\$ -	\$ 624

	<b>Construction and development</b>					
	<b>Commercial excluding</b>			<b>Real estate</b>		
	<b>and industrial</b>	<b>undeveloped land</b>	<b>undeveloped land</b>	<b>mortgage</b>	<b>Consumer</b>	<b>Total</b>
<b>Allowance for loan losses</b>						
At December 31, 2015	\$ 8,645	\$ 1,760	\$ 814	\$ 10,875	\$ 347	\$ 22,441
Provision (credit)	2,775	275	(130 )	(68 )	148	3,000
Charge-offs	(1,216 )	(133 )	-	(576 )	(568 )	(2,493 )
Recoveries	279	21	-	342	417	1,059
At December 31, 2016	\$ 10,483	\$ 1,923	\$ 684	\$ 10,573	\$ 344	\$ 24,007
Allowance for loans collectively evaluated for impairment	\$ 9,276	\$ 1,923	\$ 683	\$ 10,573	\$ 285	\$ 22,740
Allowance for loans individually evaluated for impairment	\$ 1,207	\$ -	\$ 1	\$ -	\$ 59	\$ 1,267
Allowance for loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

The considerations by Bancorp in computing its allowance for loan losses are determined based on various risk characteristics of each loan segment. Relevant risk characteristics are as follows:

**Commercial and industrial loans:** Loans in this category are made to businesses. Generally these loans are secured by assets of the business and repayment is expected from cash flows of the business. A decline in the strength of the business or a weakened economy and resultant decreased consumer and/or business spending may have an effect on credit quality in this loan category.

**Construction and development, excluding undeveloped land:** Loans in this category primarily include owner-occupied and investment construction loans and development projects. In most cases, construction loans require interest only during construction. Upon completion or stabilization, the construction loan may convert to permanent financing in the real estate mortgage segment, requiring principal amortization. Repayment of development loans is derived from sale of lots or units. Credit risk is affected by construction delays, cost overruns, market conditions and availability of permanent financing, to the extent such permanent financing is not being provided by Bancorp.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

Undeveloped land: Loans in this category are secured by land acquired for development by the borrower, but for which no development has yet taken place. Credit risk is primarily dependent upon the financial strength of the borrower, and can be affected by market conditions and time to develop land for ultimate sale. Credit risk is also affected by availability of development financing to the extent such financing is not being provided by Bancorp.

Real estate mortgage: Loans in this category are made to and secured by owner-occupied residential and commercial real estate and income-producing investment properties. For owner occupied residential and commercial real estate, repayment is dependent on financial strength of the borrower. For income-producing investment properties, repayment is dependent on financial strength of tenants and to a lesser extent, the borrower. Underlying properties are generally located in Bancorp's primary market areas. Cash flows of income producing investment properties may be adversely impacted by a downturn in the economy that may cause increased vacancy rates, which in turn, could have an effect on credit quality. Overall health of the economy, including real estate prices, has an effect on credit quality in this loan category.

Consumer: Loans in this category may be either secured or unsecured and repayment is dependent on credit quality of the individual borrower and, if applicable, adequacy of collateral securing the loan. Therefore, overall health of the economy, including unemployment rates, could have a significant effect on credit quality in this loan category.

Bancorp has loans that were acquired for which there was, at acquisition, evidence of deterioration of credit quality since origination and for which it was probable that all contractually required payments would not be collected. The carrying amount of those loans is included in the balance sheet amounts of loans at September 30, 2017 and December 31, 2016. Changes in the fair value adjustment for acquired impaired loans are shown in the following table:

(in thousands)	<b>Accretable discount</b>	<b>Non- accretable discount</b>
Balance at December 31, 2015	\$ 3	\$ 189
Accretion	(3 )	(41 )
Reclassifications from (to) non-accretable discount	-	-
Disposals	-	-
Balance at December 31, 2016	\$ -	\$ 148
Accretion	-	-
Reclassifications from (to) non-accretable discount	-	-

Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Disposals	-	-
Balance at September 30, 2017	\$ -	\$ 148

15

---

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

The following tables present loans individually evaluated for impairment as of September 30, 2017 and December 31, 2016.

(in thousands) <b>September 30, 2017</b>	<b>Recorded investment</b>	<b>Unpaid principal balance</b>	<b>Related allowance</b>	<b>Average recorded investment</b>
Loans with no related allowance recorded:				
Commercial and industrial	\$ 350	\$ 540	\$ -	\$ 228
Construction and development, excluding undeveloped land	737	907	-	533
Undeveloped land	474	506	-	413
Real estate mortgage				
Commercial investment	55	55	-	124
Owner occupied commercial	1,470	1,908	-	1,264
1-4 family residential	785	785	-	759
Home equity - first lien	-	-	-	-
Home equity - junior lien	81	81	-	224
Subtotal: Real estate mortgage	2,391	2,829	-	2,371
Consumer	-	17	-	-
Subtotal	\$ 3,952	\$ 4,799	\$ -	\$ 3,545
Loans with an allowance recorded:				
Commercial and industrial	\$ 1,787	\$ 2,321	\$ 654	\$ 2,343
Construction and development, excluding undeveloped land	-	-	-	-
Undeveloped land	-	-	-	60
Real estate mortgage				
Commercial investment	-	-	-	-
Owner occupied commercial	-	-	-	-
1-4 family residential	12	12	12	3
Home equity - first lien	-	-	-	-
Home equity - junior lien	-	-	-	-
Subtotal: Real estate mortgage	12	12	12	3
Consumer	56	56	56	58
Subtotal	\$ 1,855	\$ 2,389	\$ 722	\$ 2,464
Total:				



Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Commercial and industrial	\$ 2,137	\$ 2,861	\$ 654	\$ 2,571
Construction and development, excluding undeveloped land	737	907	-	533
Undeveloped land	474	506	-	473
Real estate mortgage				
Commercial investment	55	55	-	124
Owner occupied commercial	1,470	1,908	-	1,264
1-4 family residential	797	797	12	762
Home equity - first lien	-	-	-	-
Home equity - junior lien	81	81	-	224
Subtotal: Real estate mortgage	2,403	2,841	12	2,374
Consumer	56	73	56	58
Total	\$ 5,807	\$ 7,188	\$ 722	\$ 6,009

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

(in thousands) <b>December 31, 2016</b>	<b>Recorded investment</b>	<b>Unpaid principal balance</b>	<b>Related allowance</b>	<b>Average recorded investment</b>
Loans with no related allowance recorded:				
Commercial and industrial	\$ 322	\$ 465	\$ -	\$ 1,947
Construction and development, excluding undeveloped land	538	708	-	108
Undeveloped land	233	265	-	76
Real estate mortgage				
Commercial investment	107	107	-	193
Owner occupied commercial	1,042	1,479	-	1,356
1-4 family residential	895	896	-	962
Home equity - first lien	-	-	-	3
Home equity - junior lien	472	472	-	333
Subtotal: Real estate mortgage	2,516	2,954	-	2,847
Consumer	-	-	-	18
Subtotal	\$ 3,609	\$ 4,392	\$ -	\$ 4,996
Loans with an allowance recorded:				
Commercial and industrial	\$ 2,360	\$ 2,835	\$ 1,207	\$ 1,619
Construction and development, excluding undeveloped land	-	-	-	182
Undeveloped land	241	241	1	149
Real estate mortgage				
Commercial investment	-	-	-	-
Owner occupied commercial	-	-	-	554
1-4 family residential	-	-	-	-
Home equity - first lien	-	-	-	-
Home equity - junior lien	-	-	-	-
Subtotal: Real estate mortgage	-	-	-	554
Consumer	59	59	59	63
Subtotal	\$ 2,660	\$ 3,135	\$ 1,267	\$ 2,567
Total:				
Commercial and industrial	\$ 2,682	\$ 3,300	\$ 1,207	\$ 3,566
Construction and development, excluding undeveloped land	538	708	-	290
Undeveloped land	474	506	1	225
Real estate mortgage	-	-	-	-

Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Commercial investment	107	107	-	193
Owner occupied commercial	1,042	1,479	-	1,910
1-4 family residential	895	896	-	962
Home equity - first lien	-	-	-	3
Home equity - junior lien	472	472	-	333
Subtotal: Real estate mortgage	2,516	2,954	-	3,401
Consumer	59	59	59	81
Total	\$ 6,269	\$ 7,527	\$ 1,267	\$ 7,563

Differences between recorded investment amounts and unpaid principal balance amounts are due to partial charge-offs and interest paid on non-accrual loans which have occurred over the life of loans. Unpaid principal balance is reduced by these items to arrive at the recorded investment in the loan.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

Impaired loans include non-accrual loans and accruing loans accounted for as troubled debt restructurings (TDRs), which continue to accrue interest. Non-performing loans include the balance of impaired loans plus any loans over 90 days past due and still accruing interest. Bancorp had loans totaling \$261 thousand past due more than 90 days and still accruing interest at September 30, 2017, compared with \$438 thousand at December 31, 2016.

The following table presents the recorded investment in non-accrual loans as of September 30, 2017 and December 31, 2016.

(in thousands)	<b>September 30, 2017</b>	<b>December 31, 2016</b>
Commercial and industrial	\$ 1,256	\$ 1,767
Construction and development, excluding undeveloped land	737	538
Undeveloped land	474	474
Real estate mortgage		
Commercial investment	55	107
Owner occupied commercial	1,470	1,042
1-4 family residential	785	984
Home equity - first lien	-	-
Home equity - junior lien	81	383
Subtotal: Real estate mortgage	2,391	2,516
Consumer	-	-
Total	\$ 4,858	\$ 5,295

In the course of working with borrowers, Bancorp may elect to restructure contractual terms of certain loans. Troubled debt restructurings (TDRs) occur when, for economic or legal reasons related to a borrower's financial difficulties, Bancorp grants a concession to the borrower that it would not otherwise consider.

At September 30, 2017 Bancorp had \$949 thousand of loans classified as TDRs, all of which were accruing interest consistent with their modified terms. One residential real estate loan with a recorded investment of \$12 thousand was modified and classified as a TDR in the three-month period ended September 30, 2017. Interest due and unpaid was capitalized into the principal balance resulting in the TDR classification. A specific reserve was established for the entire recorded investment of this loan. One additional loan, a commercial loan with a recorded investment of \$35 thousand at September 30, 2017, was modified and classified as a TDR previously in the nine-month period ended

September 30, 2017. The pre and post-modification balance for this loan was \$39 thousand. The monthly payment amount of this loan was modified to enable the borrower to fulfill the loan agreement. A specific reserve was established for the entire recorded investment of this loan.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

At September 30, 2016 Bancorp had \$999 thousand of accruing loans classified as TDR. Bancorp did not modify or classify any additional loans as TDR during the three or nine month periods ended September 30, 2016.

No loans classified and reported as TDRs within the twelve months prior to September 30, 2017 defaulted during the three or nine-month periods ended September 30, 2017. Likewise, no loans classified and reported as troubled debt restructured within the twelve months prior to September 30, 2016 defaulted during the three-month or nine-month periods ended September 30, 2016. Loans accounted for as TDRs include modifications from original terms such as those due to bankruptcy proceedings, certain modifications of amortization periods or extended suspension of principal payments due to customer financial difficulties. Loans accounted for as TDRs are individually evaluated for impairment and, at September 30, 2017, had a total allowance allocation of \$142 thousand, compared with \$207 thousand at December 31, 2016.

At September 30, 2017 and December 31, 2016, Bancorp did not have any outstanding commitments to lend additional funds to borrowers whose loans have been modified as TDRs.

At September 30, 2017 formal foreclosure proceedings were in process on two loans with a total recorded investment of \$75 thousand.

The following table presents aging of the recorded investment in loans as of September 30, 2017 and December 31, 2016.

(in thousands)				<b>90 or more days past due (includes non-accrual)</b>	<b>Total past due</b>	<b>Total loans</b>	<b>Recorded investment &gt; 90 days and accruing</b>
<b>September 30, 2017</b>	<b>Current</b>	<b>30-59 days past due</b>	<b>60-89 days past due</b>				
Commercial and industrial	\$747,316	\$2,149	\$7	\$ 1,256	\$3,412	\$750,728	\$ -
Construction and development, excluding undeveloped land	173,573	-	-	737	737	174,310	-

Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Undeveloped land	20,515	-	-	474	474	20,989	-
Real estate mortgage							
Commercial investment	574,088	2,667	-	55	2,722	576,810	-
Owner occupied commercial	395,924	47	363	1,470	1,880	397,804	-
1-4 family residential	259,729	330	602	1,046	1,978	261,707	261
Home equity - first lien	51,836	89	-	-	89	51,925	-
Home equity - junior lien	62,892	165	278	81	524	63,416	-
Subtotal: Real estate mortgage	1,344,469	3,298	1,243	2,652	7,193	1,351,662	261
Consumer	37,196	226	9	-	235	37,431	-
Total	\$2,323,069	\$5,673	\$1,259	\$ 5,119	\$12,051	\$2,335,120	\$ 261

**December 31, 2016**

Commercial and industrial	\$734,682	\$84	\$290	\$ 1,785	\$2,159	\$736,841	\$ 18
Construction and development, excluding undeveloped land	191,810	-	-	538	538	192,348	-
Undeveloped land	21,022	-	-	474	474	21,496	-
Real estate mortgage							
Commercial investment	537,998	631	64	193	888	538,886	86
Owner occupied commercial	406,726	342	-	1,224	1,566	408,292	182
1-4 family residential	246,730	1,174	576	1,018	2,768	249,498	34
Home equity - first lien	55,027	231	21	46	298	55,325	46
Home equity - junior lien	66,911	99	126	383	608	67,519	72
Subtotal: Real estate mortgage	1,313,392	2,477	787	2,864	6,128	1,319,520	420
Consumer	34,965	28	105	72	205	35,170	-
Total	\$2,295,871	\$2,589	\$1,182	\$ 5,733	\$9,504	\$2,305,375	\$ 438

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Consistent with regulatory guidance, Bancorp categorizes loans into credit risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends. Pass-rated loans included all risk-rated loans other than those classified as other assets especially mentioned, substandard, and doubtful, which are defined below:

Other assets especially mentioned (“OAEM”): Loans classified as OAEM have potential weaknesses that deserve management's close attention. These potential weaknesses may result in deterioration of repayment prospects for the loan or of Bancorp's credit position at some future date.

Substandard: Loans classified as substandard are inadequately protected by the paying capacity of the obligor or of collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize repayment of the debt. Default is a distinct possibility if deficiencies are not corrected.

Substandard non-performing: Loans classified as substandard non-performing have all the characteristics of substandard loans and have been placed on non-accrual status or have been accounted for as troubled debt restructurings. Loans are placed on non-accrual status when prospects for recovering both principal and accrued interest are considered doubtful or when a default of principal or interest has existed for 90 days or more. While on non-accrual status, payments of interest are applied to reduce the recorded investment in the loan.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make repayment on the basis of currently existing facts, conditions and values, highly questionable and improbable.



Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

As of September 30, 2017 and December 31, 2016, the internally assigned risk grades of loans by category were as follows:

(in thousands)				<b>Substandard</b>	<b>Doubtful</b>	<b>Total</b>
<b>September 30, 2017</b>	<b>Pass</b>	<b>OAEM</b>	<b>Substandard</b>	<b>non-performing</b>	<b>loans</b>	
Commercial and industrial	\$726,194	\$7,464	\$ 14,197	\$ 2,873	\$ -	\$750,728
Construction and development, excluding undeveloped land	174,310	-	-	-	-	174,310
Undeveloped land	20,485	-	30	474	-	20,989
Real estate mortgage						
Commercial investment	575,339	761	420	290	-	576,810
Owner occupied commercial	383,387	10,313	2,869	1,235	-	397,804
1-4 family residential	256,458	3,018	1,172	1,059	-	261,707
Home equity - first lien	51,923	2	-	-	-	51,925
Home equity - junior lien	63,029	73	233	81	-	63,416
Subtotal: Real estate mortgage	1,330,136	14,167	4,694	2,665	-	1,351,662
Consumer	37,269	102	4	56	-	37,431
Total	\$2,288,394	\$21,733	\$ 18,925	\$ 6,068	\$ -	\$2,335,120
<b>December 31, 2016</b>						
Commercial and industrial	\$714,025	\$14,266	\$ 5,850	\$ 2,700	\$ -	\$736,841
Construction and development, excluding undeveloped land	191,455	-	355	538	-	192,348
Undeveloped land	21,022	-	-	474	-	21,496
Real estate mortgage						
Commercial investment	538,688	-	5	193	-	538,886
Owner occupied commercial	396,997	7,960	2,111	1,224	-	408,292
1-4 family residential	247,888	-	592	1,018	-	249,498
Home equity - first lien	55,279	-	-	46	-	55,325
Home equity - junior lien	66,710	-	426	383	-	67,519
Subtotal: Real estate mortgage	1,305,562	7,960	3,134	2,864	-	1,319,520
Consumer	35,039	-	-	131	-	35,170
Total	\$2,267,103	\$22,226	\$ 9,339	\$ 6,707	\$ -	\$2,305,375



Table of Contents**Stock Yards Bancorp, inc. and subsidiary****(4) Goodwill and Intangible Assets**

US GAAP requires that goodwill and intangible assets with indefinite useful lives not be amortized, but instead be tested for impairment at least annually. Evaluations have resulted in no indication of impairment. Bancorp currently has goodwill in the amount of \$682 thousand from the 1996 acquisition of an Indiana bank. This goodwill is assigned to the commercial banking segment of Bancorp.

Bancorp recorded a gross core deposit intangible totaling \$2.5 million as a result of its 2013 acquisition of THE BANCORP, Inc. This intangible is being amortized over the expected life of the underlying deposits to which the intangible is attributable. At September 30, 2017, the unamortized core deposit intangible was \$1.3 million, as compared to \$1.4 million at December 31, 2016.

Mortgage servicing rights (MSRs) are initially recognized at fair value when mortgage loans are sold with servicing retained. The MSRs are amortized in proportion to and over the period of estimated net servicing income, considering appropriate prepayment assumptions. MSRs are evaluated quarterly for impairment by comparing carrying value to fair value. Estimated fair values of MSRs at both September 30, 2017 and December 31, 2016 were \$2.7 million. Total outstanding principal balances of loans serviced for others were \$350.1 million and \$372.2 million at September 30, 2017, and December 31, 2016, respectively.

Changes in the net carrying amount of MSRs for the nine months ended September 30, 2017 and 2016 are shown in the following table:

(in thousands)	<b>For the nine months ended September 30,</b>	
	<b>2017</b>	<b>2016</b>
Balance at beginning of period	\$921	\$1,018
Additions for mortgage loans sold	143	105
Amortization	(222)	(192 )
Balance at end of period	\$842	\$931



Table of Contents**Stock Yards Bancorp, inc. and subsidiary****(5) Income Taxes**

Components of income tax expense from operations were as follows:

(in thousands)	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Current income tax expense				
Federal	\$5,211	\$4,363	\$12,936	\$10,958
State	179	287	472	597
Total current income tax expense	5,390	4,650	13,408	11,555
Deferred income tax (benefit) expense				
Federal	(1,583)	(692 )	(2,240 )	(302 )
State	(44 )	(75 )	(30 )	(18 )
Total deferred income tax expense (benefit)	(1,627)	(767 )	(2,270 )	(320 )
Change in valuation allowance	333	-	459	-
Total income tax expense	\$4,096	\$3,883	\$11,597	\$11,235

An analysis of the difference between statutory and effective income tax rates for the nine months ended September 30, 2017 and 2016 follows:

	<b>Nine months ended September 30,</b>	
	<b>2017</b>	<b>2016</b>
U.S. federal statutory income tax rate	35.0%	35.0%
Tax credits	(4.6)	(9.4)
Excess tax benefits from share-based compensation arrangements	(3.0)	-
Increase in cash surrender value of life insurance	(1.4)	(0.9)
Tax exempt interest income	(1.1)	(1.3)
State income taxes, net of federal benefit	0.7	0.9

Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Other, net	0.3	2.7
Effective income tax rate	25.9%	27.0%

State income tax expense represents taxes owed in Indiana. State income taxes in Kentucky and Ohio are based on capital levels, and are recorded as other non-interest expense.

Bancorp's results for the first nine months of 2017 reflect implementation of Accounting Standards Update 2016-09, which provides guidance for the recognition of excess tax benefits or deficiencies related to share-based payment awards. Effective for fiscal years beginning after December 15, 2016, ASU 2016-09 changes the way these benefits and deficiencies are recorded. Prior to 2017 they were recorded in additional paid-in capital, and therefore did not affect earnings. Beginning in 2017, these amounts are being recorded as tax expense or benefit in the income statement. For the three and nine month periods ending September 30, 2017 Bancorp recorded benefits of \$241 thousand and \$1.4 million, respectively, within the provision for income tax expense for such awards.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

US GAAP provides guidance on financial statement recognition and measurement of tax positions taken, or expected to be taken, in tax returns. If recognized, tax benefits would reduce tax expense and accordingly, increase net income. The amount of unrecognized tax benefits may increase or decrease in the future for various reasons including adding amounts for current year tax positions, expiration of open income tax returns due to statutes of limitation, changes in management's judgment about the level of uncertainty, status of examination, litigation and legislative activity and addition or elimination of uncertain tax positions. As of September 30, 2017 and December 31, 2016, the gross amount of unrecognized tax benefits was immaterial to the consolidated financial statements of the Company. Federal and state income tax returns are subject to examination for the years after 2012.

**(6) Deposits**

The composition of the Bank's deposits outstanding at September 30, 2017 (unaudited) and December 31, 2016 is as follows:

	<b>September 30, 2017</b>	<b>December 31, 2016</b>
(in thousands)		
Non-interest bearing demand	\$676,824	\$680,156
Interest bearing deposits:		
Interest bearing demand	725,368	768,139
Savings	149,596	140,030
Money market	698,198	682,421
Time deposits of more than \$250,000	33,270	40,427
Other time deposits	198,710	209,375
Total time deposits	231,980	249,802
Total interest bearing deposits	1,805,142	1,840,392
Total deposits	\$2,481,966	\$2,520,548

Maturities of time deposits of more than \$250,000, outstanding at September 30, 2017, are summarized as follows:

	<b>Amount</b>
(in thousands)	
3 months or less	\$11,463
Over 3 through 6 months	3,938
Over 6 through 12 months	10,942
Over 1 through 3 years	6,410
Over 3 years	517
Total	\$33,270



Table of Contents**Stock Yards Bancorp, inc. and subsidiary****(7) Securities Sold Under Agreements to Repurchase**

Securities sold under agreements to repurchase, which represent excess funds from commercial customers as part of a cash management service, totaled \$71.9 million and \$67.6 million at September 30, 2017 and December 31, 2016, respectively. Bancorp enters into sales of securities under agreement to repurchase at a specified future date. At September 30, 2017, all of these financing arrangements had overnight maturities and were secured by government sponsored enterprise obligations and government agency mortgage-backed securities which were owned by and under the control of Bancorp.

**(8) Federal Home Loan Bank Advances**

Bancorp had outstanding borrowings totaling \$50.1 million and \$51.1 million at September 30, 2017 and December 31, 2016, respectively, via 14 separate fixed-rate advances. As of September 30, 2017, for two advances totaling \$30 million, both of which are non-callable, interest payments are due monthly, with principal due at maturity. For the remaining advances totaling \$20.1 million, principal and interest payments are due monthly based on an amortization schedule.

The following is a summary of contractual maturities and average effective rates of outstanding advances:

(In thousands)	September 30, 2017		December 31, 2016	
	Advance	Fixed Rate	Advance	Fixed Rate
2017	\$30,000	1.24 %	\$30,000	0.70 %
2020	1,753	2.23	1,790	2.23
2021	306	2.12	359	2.12
2024	2,505	2.36	2,661	2.36
2025	5,615	2.43	6,025	2.43
2026	8,658	1.99	8,936	1.99
2028	1,273	1.48	1,304	1.48
Total	\$50,110	1.61 %	\$51,075	1.30 %

In addition to fixed-rate advances listed above, at September 30, 2017 Bancorp had a \$150 million cash management advance from the FHLB. This advance matured in the first week of October, 2017 and was used to manage Bancorp's overall cash position. Due to the short term of the advance, it was recorded on the consolidated balance sheet within Federal funds purchased and other short-term borrowings.

Advances from the FHLB are collateralized by certain commercial and residential real estate mortgage loans under a blanket mortgage collateral agreement and FHLB stock. Bancorp at times utilizes these borrowings to match fund long-term fixed rate loans. At September 30, 2017, the amount of available credit from the FHLB totaled \$367.3 million.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary****(9) Other Comprehensive Income**

The following table illustrates activity within the balances of accumulated other comprehensive income by component, and is shown for the nine months ended September 30, 2017 and 2016.

(in thousands)	Net unrealized gains on securities available-for-sale	Net unrealized gains (losses) on cash flow hedges	Minimum pension liability adjustment	Total
Balance at December 31, 2015	\$ 965	\$ (60 )	\$ (273 )	\$632
Net current period other comprehensive gain (loss)	4,110	(301 )	-	3,809
Balance at September 30, 2016	\$ 5,075	\$ (361 )	\$ (273 )	\$4,441
Balance at December 31, 2016	\$ (1,211 )	\$ (16 )	\$ (272 )	\$(1,499)
Net current period other comprehensive income gain	950	38	-	988
Amounts reclassified from other comprehensive income	(20 )	-	-	(20 )
Net current-period other comprehensive income	930	38	-	968
Balance at September 30, 2017	\$ (281 )	\$ 22	\$ (272 )	\$(531 )

**(10) Preferred Stock**

Bancorp has a class of preferred stock (no par value; 1,000,000 shares authorized), the relative rights, preferences and other terms of which or any series within the class will be determined by the Board of Directors prior to any issuance. None of this stock has been issued to date.



Table of Contents**Stock Yards Bancorp, inc. and subsidiary****(11) Net Income Per Share**

The following table reflects, for the three and nine months ended September 30, 2017 and 2016, net income (numerator) and average shares outstanding (denominator) for basic and diluted net income per share computations:

(in thousands, except per share data)	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30, 2017</b>	<b>2016</b>	<b>September 30, 2017</b>	<b>2016</b>
Net income	\$11,704	\$10,467	\$33,097	\$30,411
Average basic shares outstanding	22,542	22,385	22,524	22,325
Dilutive securities	422	418	460	386
Average shares outstanding including dilutive securities including dilutive securities	22,964	22,803	22,984	22,711
Net income per share, basic	\$0.52	\$0.47	\$1.47	\$1.36
Net income per share, diluted	\$0.51	\$0.46	\$1.44	\$1.34

**(12) Defined Benefit Retirement Plan**

Bancorp sponsors an unfunded, non-qualified, defined benefit retirement plan for three key officers (two current and one retired), and has no plans to increase the number of or benefits to participants. Benefits vest based on 25 years of service. All three officers are fully vested as of September 2017. Actuarially determined pension costs are expensed and accrued over the service period, and benefits are paid from Bancorp's assets. Net periodic benefits costs, which include interest cost and amortization of net losses, totaled \$34 thousand and \$33 thousand for the three-month periods ended September 30, 2017 and 2016, respectively. For the nine months ended September 30, 2017 and 2016, the net periodic benefit costs totaled \$103 thousand and \$100 thousand, respectively.

**(13) Stock-Based Compensation**

The fair value of all awards granted, net of estimated forfeitures, is recognized as compensation expense over the respective service period.

Bancorp currently has one stock-based compensation plan. At Bancorp's 2015 Annual Meeting of Shareholders, shareholders approved the 2015 Omnibus Equity Compensation Plan and authorized the shares available from the expiring 2005 plan for future awards under the 2015 plan. No additional shares were made available. As of September 30, 2017, there were 285,133 shares available for future awards.

Options, which have not been granted since 2007, had a vesting schedule of 20% per year and as of February 2017; all options have been exercised or expired. Stock appreciation rights ("SARs") have a vesting schedule of 20% per year. SARs expire ten years after the grant date unless unvested grants are forfeited due to employment termination. SARs granted under the 2005 plan expire as late as 2025.

Restricted shares granted to officers vest over five years. All restricted shares have been granted at a price equal to the market value of common stock at the time of grant. For all grants prior to 2015, grantees were entitled to dividend payments during the vesting period. For grants in 2015 and after, forfeitable dividends are deferred until shares are vested.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

Grants of performance stock units (“PSUs”) vest based upon service and a three-year performance period which begins January 1 of the first year of the performance period. Because grantees are not entitled to dividend payments during the performance period, the fair value of these PSUs is estimated based upon the fair value of the underlying shares on the date of grant, adjusted for non-payment of dividends. Beginning in 2015, grants require a one year post-vesting holding period. For 2015, 2016 and 2017, the fair value of such grants incorporates a liquidity discount of 4.80%, 4.50% and 5.12%, respectively, related to the holding period.

Grants of restricted stock units (“RSUs”) to directors are time-based and vest 12 months after grant date. Because grantees are entitled to deferred dividend payments at the end of the vesting period, fair value of the RSUs is equal to the fair value of underlying shares on the date of grant.

Bancorp has recognized stock-based compensation expense, within salaries and employee benefits for employees, and within other non-interest expense for directors, in the consolidated statements of income as follows:

	<b>For three months ended September 30,</b>		<b>For nine months ended September 30,</b>	
(in thousands)	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Stock-based compensation expense before income taxes	\$670	\$573	\$2,012	\$1,646
Less: deferred tax benefit	(235)	(200)	(704)	(576)
Reduction of net income	\$435	\$373	\$1,308	\$1,070

Bancorp’s net income for the three and nine-month periods ended September 30, 2017 reflected the implementation of ASU 2016-09 which changed the way excess tax benefits and deficiencies related to share-based compensation are recorded. Prior to 2017 these were recorded directly to additional paid-in capital and, thus did not affect earnings. Beginning in 2017 these are recorded as a tax expense or benefit in the income statement. For the three and nine months ended September 30, 2017 these benefits resulted in a \$241 thousand and a \$1.4 million increase in net income, respectively. This tax benefit is not reflected in the table above.

Bancorp expects to record an additional \$679 thousand of stock-based compensation expense in 2017 for equity grants outstanding as of September 30, 2017. As of September 30, 2017, Bancorp has \$4.9 million of unrecognized stock-based compensation expense that is expected to be recorded as compensation expense over the next five years as awards vest. Bancorp used cash of \$216 thousand during the first nine months of 2017 for purchase of shares upon vesting of restricted stock units, net of cash received for options exercised. This compares to cash received of \$1.6 million during the first nine months of 2016 for similar activity.



Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

Fair values of Bancorp's SARs are estimated at the date of grant using the Black-Scholes option pricing model, a leading formula for calculating the value of stock options and SARs. This model requires input of assumptions, changes to which can materially affect the fair value estimate. Fair value of restricted shares is equal to Bancorp's closing stock price on the date of grant. The following assumptions were used in SAR valuations at the grant date in each year:

	2017	2016
Dividend yield	2.72 %	2.94 %
Expected volatility	19.47 %	19.31 %
Risk free interest rate	2.29 %	1.70 %
Expected life of SARs (in years)	7.0	7.3

Dividend yield and expected volatility are based on historical information for Bancorp for time periods corresponding to the expected life of options and SARs granted. Expected volatility is the price volatility of the underlying shares for the expected term measured on a monthly basis. The risk free interest rate is the implied yield currently available on U.S. Treasury issues with a remaining term equal to the expected life of the award. The expected life of SARs is based on actual experience of past like-term SARs. Bancorp evaluates historical exercise and post-vesting termination behavior when determining the expected life.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

A summary of stock option and SARs activity and related information for the twelve month period ended December 31, 2016 and the nine month period ended September 30, 2017 follows:

	<b>Options and SARs (in thousands)</b>	<b>Exercise price</b>	<b>Weighted average exercise price</b>	<b>Aggregate intrinsic value (in thousands)</b>	<b>Weighted average fair value</b>	<b>Weighted average remaining contractual life (in years)</b>
At December 31, 2015						
Vested and exercisable	656	\$14.02- 19.44	\$ 15.75	\$ 6,191	\$ 3.39	3.7
Unvested	266	15.24-24.55	18.66	1,733	3.29	7.7
Total outstanding	922	14.02-24.55	16.59	7,924	3.36	4.8
Granted	88	25.76-33.08	25.84	1,866	3.56	
Exercised	(272 )	) 14.02-17.89	16.38	4,155	3.73	
Forfeited	(3 )	) 14.02-15.84	15.18	60	2.94	
At December 31, 2016						
Vested and exercisable	475	14.02-24.56	15.72	14,820	3.16	4.3
Unvested	260	15.24-33.08	21.53	6,623	3.43	7.8
Total outstanding	735	14.02-33.08	17.78	21,443	3.26	5.5
Granted	46	40.00-40.00	40.00	-	6.34	
Exercised	(47 )	) 14.02-17.89	15.52	1,168	3.27	
Forfeited	-	-	-	-	-	
At September 30, 2017						
Vested and exercisable	519	14.02-25.76	16.39	11,218	3.15	4.3
Unvested	215	15.24-40.00	26.45	2,567	4.17	7.9
Total outstanding	734	14.02-40.00	19.17	\$ 13,785	3.45	5.3
Vested year-to-date	92	\$15.24-25.76	\$ 19.34	\$ 1,723	\$ 3.18	

Intrinsic value for stock options and SARs is defined as the amount by which the current market price of the underlying stock exceeds the exercise or grant price. 46,410 shares had an intrinsic value of zero because the exercise

price for those shares exceeded the current market price at September 30, 2017. There are no options outstanding as of September 30, 2017; all have been exercised or have expired.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

A summary of activity for restricted shares of common stock granted to officers for the periods ending December 31, 2016 and September 30, 2017 is outlined in the following table:

	<b>Number</b>	<b>Grant date weighted- average cost</b>
Unvested at December 31, 2015	155,858	\$ 18.98
2016 activity:		
Shares awarded	51,122	25.78
Restrictions lapsed and shares released	(49,265 )	17.98
Shares forfeited	(12,480 )	20.69
Unvested at December 31, 2016	145,235	\$ 21.57
2017 activity:		
Shares awarded	28,625	44.85
Restrictions lapsed and shares released	(46,220 )	19.76
Shares forfeited	(7,154 )	25.03
Unvested at September 30, 2017	120,486	\$ 27.59

Bancorp awarded PSUs to executive officers of Bancorp, the three-year performance period for which began January 1 of the award year. Shares awarded in 2017 under the 2014 grant totaled 50,022. Shares awarded in 2016 under the 2013 grant totaled 55,188.

The following table outlines outstanding PSU grants:

<b>Grant year</b>	<b>Vesting period in years</b>	<b>Fair value</b>	<b>Expected shares to be awarded</b>
2015	3	\$20.02	51,910
2016	3	22.61	58,786
2017	3	35.66	24,756

In the first quarter of 2017, Bancorp awarded 4,680 RSUs to directors of Bancorp with a grant date fair value of \$220 thousand. No awards were made in the second or third quarters of 2017.

**(14) Stock Split**

In April 2016 Bancorp declared a 3 for 2 stock split effected as a 50% stock dividend payable in May 2016. Share and per share information has been adjusted for this split.

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

**(15) Commitments and Contingent Liabilities**

As of September 30, 2017, Bancorp had various commitments outstanding that arose in the normal course of business, including standby letters of credit and commitments to extend credit, which are properly not reflected in the consolidated financial statements. In management's opinion, at September 30, 2017 commitments to extend credit of \$709.7 million, including standby letters of credit of \$17.6 million, represent normal banking transactions. Commitments to extend credit were \$628.3 million, including letters of credit of \$15.6 million, as of December 31, 2016. Commitments to extend credit are an agreement to lend to a customer as long as collateral is available and there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Commitments to extend credit are mainly comprised of commercial lines of credit, construction and home equity credit lines and credit cards issued to commercial customers. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Bancorp uses the same credit and collateral policies in making commitments and conditional guarantees as for on-balance sheet instruments. Bancorp evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if any, is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, equipment, and real estate. However, should the commitments be drawn upon and should our customers default on their resulting obligation to us, our maximum exposure to credit loss, without consideration of collateral, is represented by the contractual amount of those instruments. At September 30, 2017, Bancorp had accrued \$350 thousand in other liabilities for inherent risks related to unfunded credit commitments.

Standby letters of credit and financial guarantees written are conditional commitments issued by Bancorp to guarantee the performance of a customer to a first party. Those guarantees are primarily issued to support customer commercial transactions. Standby letters of credit generally have maturities of one to two years.

As part of the normal course of business Bancorp entered into an agreement to purchase 29 automatic teller machines (ATMs) over the next three years at a total price of \$1.2 million. Management was able to secure favorable pricing by contractually committing to purchase the machines.

Also, as of September 30, 2017, in the normal course of business, there were pending legal actions and administrative proceedings in which claims for damages are asserted and/or losses could be incurred. We record a liability for these matters if an unfavorable outcome is probable and the amount of loss can be reasonably estimated, including expected insurance coverage. For proceedings where the reasonable estimate of loss is a range, we record a best estimate of loss within the range. At September 30, 2017 we have recorded a liability of \$266 thousand for such matters.

**(16) Assets and Liabilities Measured and Reported at Fair Value**

Bancorp follows the provisions of authoritative guidance for fair value measurements. This guidance is definitional and disclosure oriented and addresses how companies should approach measuring fair value when required by US GAAP. The guidance also prescribes various disclosures about financial statement categories and amounts which are measured at fair value, if such disclosures are not already specified elsewhere in US GAAP.

Authoritative guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between participants at the measurement date. The guidance also establishes a hierarchy to group assets and liabilities carried at fair value in three levels based upon the markets in which the assets and liabilities trade and the source of assumptions used to determine fair value. These levels are:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions would reflect internal estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques could include pricing models, discounted cash flows and other similar techniques.

Authoritative guidance requires maximum use of observable inputs and minimum use of unobservable inputs in fair value measurements. Where there exists limited or no observable market data, Bancorp derives its own estimates by generally considering characteristics of the asset/liability, the current economic and competitive environment and other factors. For this reason, results cannot be determined with precision and may not be realized on an actual sale or immediate settlement of the asset or liability.

Bancorp's investment securities available-for-sale and interest rate swaps are recorded at fair value on a recurring basis. Other accounts including mortgage servicing rights, impaired loans and other real estate owned may be recorded at fair value on a non-recurring basis, generally in the application of lower of cost or market adjustments or write-downs of specific assets.

The portfolio of investment securities available-for-sale is comprised of U.S. Treasury and other U.S. government obligations, debt securities of U.S. government-sponsored corporations (including mortgage-backed securities), obligations of state and political subdivisions and corporate equity securities. U.S. Treasury and publicly traded corporate equity securities are priced using quoted prices of identical securities in an active market. These measurements are classified as Level 1 in the hierarchy above. All other securities are priced using standard industry models or matrices with various assumptions such as yield curves, volatility, prepayment speeds, default rates, time value, credit rating and market prices for similar instruments. These assumptions are generally observable in the market place and can be derived from or supported by observable data. These measurements are classified as Level 2 in the hierarchy above.

Interest rate swaps are valued using primarily Level 2 inputs. Fair value measurements generally based on benchmark forward yield curves and other relevant observable market data. For purposes of potential valuation adjustments to derivative positions, Bancorp evaluates the credit risk of its counterparties as well as its own credit risk. To date, Bancorp has not realized any losses due to a counterparty's inability to perform and the change in value of derivative



assets and liabilities attributable to credit risk was not significant during 2017.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

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

(in thousands)	<b>Fair value at September 30, 2017</b>			
	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>				
<b>Investment securities available-for-sale</b>				
Government sponsored enterprise obligations	\$372,664	\$-	\$372,664	\$-
Mortgage-backed securities - government agencies	146,720	-	146,720	-
Obligations of states and political subdivisions	51,622	-	51,622	-
Corporate equity securities	516	516	-	-
<b>Total investment securities available-for-sale</b>	<b>571,522</b>	<b>516</b>	<b>571,006</b>	<b>-</b>
<b>Interest rate swaps</b>	<b>182</b>	<b>-</b>	<b>182</b>	<b>-</b>
<b>Total assets</b>	<b>\$571,704</b>	<b>\$516</b>	<b>\$571,188</b>	<b>\$-</b>
<b>Liabilities</b>				
<b>Interest rate swaps</b>	<b>\$148</b>	<b>\$-</b>	<b>\$148</b>	<b>\$-</b>

(in thousands)	<b>Fair value at December 31, 2016</b>			
	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>				
<b>Investment securities available-for-sale</b>				
U.S. Treasury and other U.S. government obligations	\$74,998	\$74,998	\$-	\$-
Government sponsored enterprise obligations	268,090	-	268,090	-
Mortgage-backed securities - government agencies	168,843	-	168,843	-
Obligations of states and political subdivisions	57,444	-	57,444	-
Corporate equity securities	699	699	-	-
<b>Total investment securities available-for-sale</b>	<b>570,074</b>	<b>75,697</b>	<b>494,377</b>	<b>-</b>
<b>Interest rate swaps</b>	<b>203</b>	<b>-</b>	<b>203</b>	<b>-</b>

<b>Total assets</b>	\$570,277	\$75,697	\$494,580	\$ -
<b>Liabilities</b>				
<b>Interest rate swaps</b>	\$178	\$-	\$178	\$ -

Bancorp had no financial instruments classified within Level 3 of the valuation hierarchy for assets and liabilities measured at fair value on a recurring basis at September 30, 2017 or December 31, 2016.

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

MSRs are recorded at fair value upon capitalization, are amortized to correspond with estimated servicing income, and are periodically assessed for impairment based on fair value at the reporting date. Fair value is based on a valuation model that calculates the present value of estimated net servicing income. The model incorporates assumptions that market participants would use in estimating future net servicing income. These measurements are classified as Level 3. At September 30, 2017 and December 31, 2016 there was no valuation allowance for the mortgage servicing rights, as fair value exceeded cost. Accordingly, MSRs are not included in either table below for September 30, 2017 or December 31, 2016. See Note 4 for more information regarding MSRs.

For impaired loans in the table below, fair value is calculated as carrying value of loans with a specific valuation allowance, less the specific allowance, and the carrying value of collateral dependent loans that have been charged down to their fair value. Fair value of impaired loans was primarily measured based on the value of the collateral securing these loans. Impaired loans are classified within Level 3 of the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory, and/or accounts receivable. Bancorp determines value of real estate collateral based on independent appraisals performed by qualified licensed appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Appraised values are discounted for costs to sell and may be discounted further based on management's historical knowledge, changes in market conditions from the date of the most recent appraisal, and/or management's expertise and knowledge of the customer and the customer's business. Such discounts by management are subjective and are typically significant unobservable inputs for determining fair value. For other assets, Bancorp relies on both internal and third party assessments of asset value, based on information provided by the borrower, following methodologies similar to those described for real estate. As of September 30, 2017, total impaired collateral dependent loans charged down to their fair value and impaired loans with a valuation allowance were \$3.2 million, and the specific allowance totaled \$722 thousand, resulting in a fair value of \$2.5 million, compared with total collateral dependent loans charged down to their fair value and impaired loans with a valuation allowance of \$4.2 million, and the specific allowance allocation totaling \$1.3 million, resulting in a fair value of \$2.9 million at December 31, 2016. Losses represent charge offs and changes in specific allowances for the period indicated.

Other real estate owned ("OREO"), which is carried at the lower of cost or fair value, is periodically assessed for impairment based on fair value at the reporting date. Fair value is based on appraisals performed by external parties which use judgments and assumptions that are property-specific and sensitive to changes in the overall economic environment. Appraisals may be further discounted based on management's historical knowledge and/or changes in market conditions from the date of the most recent appraisal. Many of these inputs are not observable and, accordingly, these measurements are classified as Level 3. For OREO in the table below, fair value is the carrying value of only parcels of OREO which have a carrying value equal to appraised value. Losses represent write-downs which occurred during the period indicated. At September 30, 2017 and December 31, 2016, carrying value of all other real estate owned was \$2.6 million and \$5.0 million, respectively.



Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

Below are carrying values of assets measured at fair value on a non-recurring basis. Impaired loan amounts reported represent only those impaired loans with specific valuation allowances and collateral dependent impaired loans charged down to their carrying value.

(in thousands)	<b>Fair value at September 30, 2017</b>				<b>Losses for 9 month period ended September 30, 2017</b>
	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Impaired loans	\$2,530	\$ -	\$ -	\$2,530	\$ (280 )
Other real estate owned	2,640	-	-	2,640	(171 )
<b>Total</b>	<b>\$5,170</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$5,170</b>	<b>\$ (451 )</b>

(in thousands)	<b>Fair value at December 31, 2016</b>				<b>Losses for 9 month period ended September 30, 2016</b>
	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Impaired loans	\$2,933	\$ -	\$ -	\$2,933	\$ (1,612 )
Other real estate owned	4,488	-	-	4,488	(62 )
<b>Total</b>	<b>\$7,421</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$7,421</b>	<b>\$ (1,674 )</b>

For the securities portfolio, Bancorp monitors the valuation technique used by pricing agencies to ascertain when transfers between levels have occurred. The nature of other assets and liabilities measured at fair value is such that transfers in and out of any level are expected to be rare. For the nine months ended September 30, 2017, there were no transfers between Levels 1, 2, or 3. For Level 3 assets measured at fair value on a non-recurring basis as of September 30, 2017, significant unobservable inputs used in fair value measurements are presented below.

**Fair                      Significant                      Weighted**  
**Valuation                      unobservable**

(dollars in thousands)	<b>Value</b>	<b>technique</b>	<b>input</b>	<b>average of input</b>	
Impaired loans - collateral dependent	\$2,530	Appraisal	Appraisal discounts	15.0	%
Other real estate owned	2,640	Appraisal	Appraisal discounts	23.4	

Table of Contents**Stock Yards Bancorp, inc. and subsidiary****(17) Disclosure of Financial Instruments Not Reported at Fair Value**

US GAAP requires disclosure of the fair value of financial assets and liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or nonrecurring basis. Carrying amounts, estimated fair values, and placement in the fair value hierarchy of Bancorp's financial instruments are as follows:

(in thousands) <b>September 30, 2017</b>	<b>Carrying amount</b>	<b>Fair value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Financial assets</b>					
Cash and short-term investments	\$ 129,078	\$ 129,078	\$ 129,078	\$-	\$-
Mortgage loans held for sale	5,459	6,005	-	6,005	-
Federal Home Loan Bank stock and other securities	7,666	7,666	-	7,666	-
Loans, net	2,310,172	2,302,466	-	-	2,302,466
Accrued interest receivable	8,162	8,162	8,162	-	-
<b>Financial liabilities</b>					
Deposits	2,481,966	2,480,641	-	-	2,480,641
Short-term borrowings	233,824	233,824	-	233,824	-
FHLB advances	50,110	50,070	-	50,070	-
Secured borrowings	18,351	-	-	-	18,210
Accrued interest payable	212	212	212	-	-
(in thousands) <b>December 31, 2016</b>	<b>Carrying amount</b>	<b>Fair value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Financial assets</b>					
Cash and short-term investments	\$ 47,973	\$ 47,973	\$ 47,973	\$-	\$-
Mortgage loans held for sale	3,213	3,481	-	3,481	-
Federal Home Loan Bank stock and other securities	6,347	6,347	-	6,347	-
Loans, net	2,281,368	2,284,569	-	-	2,284,569
Accrued interest receivable	6,878	6,878	6,878	-	-
<b>Financial liabilities</b>					
Deposits	2,520,548	2,519,725	-	-	2,519,725



Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Short-term borrowings	114,969	114,969	-	114,969	-
FHLB advances	51,075	50,806	-	50,806	-
Secured borrowings	15,814				15,731
Accrued interest payable	144	144	144	-	-

37

---

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

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

**Cash, short-term investments, accrued interest receivable/payable and short-term borrowings**

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

**Mortgage loans held for sale**

Mortgage loans held for sale are initially recorded at the lower of cost or market value. The portfolio is comprised of residential real estate loans and fair value is determined by market quotes for similar loans based on loan type, term, rate, size and the borrower's credit score.

**Federal Home Loan Bank stock and other securities**

For these securities without readily available market values, carrying amount is a reasonable estimate of fair value as it equals the amount due from FHLB or other issuer at upon redemption.

**Loans, net**

US GAAP prescribes the exit price concept for estimating fair value of loans. Because there is not an active market (exit price) for trading virtually all types of loans in Bancorp's portfolio, fair value of loans is estimated by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities (entrance price).

## **Deposits**

Fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. Fair value of fixed-rate certificates of deposits is estimated by discounting future cash flows using the rates currently offered for deposits of similar remaining maturities.

## **Federal Home Loan Bank advances**

Fair value of FHLB advances is estimated by discounting future cash flows using estimates of current market rate for instruments with similar terms and remaining maturities.

**Secured Borrowings** Secured borrowings represent sold participation loans for which Bancorp has retained effective control of the loans, typically by restricting the participating institutions from pledging or selling their share of the loan without permission from Bancorp. US GAAP requires the participated portion of these loans to be recorded as secured borrowings. Secured borrowings are included in other liabilities on the consolidated balance sheets.

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

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

## **Limitations**

Fair value estimates are made at a specific point in time based on relevant market information and information about financial instruments. Because no market exists for a significant portion of Bancorp's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Therefore, calculated fair value estimates in many instances cannot be substantiated by comparison to independent markets and, in many cases, may not be realizable in a current sale of the instrument. Changes in assumptions could significantly affect estimates.



Table of Contents**Stock Yards Bancorp, inc. and subsidiary****(18) Derivative Financial Instruments**

Periodically, Bancorp enters into an interest rate swap transaction with a borrower, who desires to hedge their exposure to rising interest rates, while at the same time entering into an offsetting interest rate swap, with substantially matching terms, with another approved independent counterparty. These are undesignated derivative instruments and are recognized on the consolidated balance sheet at fair value. Because of matching terms of offsetting contracts and collateral provisions mitigating any non-performance risk, changes in fair value subsequent to initial recognition are expected to have an insignificant effect on earnings. Exchanges of cash flows related to undesignated interest rate swap agreements for the first nine months of 2017 were offsetting and therefore had no net effect on Bancorp's earnings or cash flows.

Interest rate swap agreements derive their value from underlying interest rates. These transactions involve both credit and market risk. Notional amounts are amounts on which calculations, payments, and the value of the derivative are based. Notional amounts do not represent direct credit exposure. Direct credit exposure is limited to the net difference between calculated amounts to be received and paid, if any. Bancorp is exposed to credit-related losses in the event of nonperformance by counterparties to these agreements. Bancorp mitigates credit risk of its financial contracts through credit approvals, limits, collateral, and monitoring procedures, and does not expect any counterparties to fail their obligations.

At September 30, 2017 and December 31, 2016, Bancorp had outstanding undesignated interest rate swap contracts as follows:

(dollar amounts in thousands)	<b>Receiving</b>		<b>Paying</b>	
	<b>September 30, 2017</b>	<b>December 31, 2016</b>	<b>September 30, 2017</b>	<b>December 31, 2016</b>
Notional amount	\$53,214	\$43,986	\$53,214	\$43,986
Weighted average maturity (years)	8.9	9.9	8.9	9.9
Fair value	\$148	\$(178)	\$(148)	\$178

In 2016, Bancorp entered into an interest rate swap to hedge cash flows of a \$10 million rolling fixed-rate three-month FHLB borrowing. The swap began December 6, 2016 and ends December 6, 2021. In 2015, Bancorp entered into an

interest rate swap to hedge cash flows of a \$20 million rolling fixed-rate three-month FHLB borrowing. The swap began December 9, 2015 and matures December 6, 2020. For purposes of hedging, rolling fixed rate advances are considered to be floating rate liabilities. Interest rate swaps involve exchange of Bancorp's floating rate interest payments for fixed rate swap payments on underlying principal amounts. These swaps were designated, and qualified, for cash-flow hedge accounting. For derivative instruments that are designated and qualify as cash flow hedging instruments, the effective portion of gains or losses is reported as a component of other comprehensive income, and is subsequently reclassified into earnings as an adjustment to interest expense in periods in which the hedged forecasted transaction affects earnings.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

The following table details Bancorp's derivative position designated as a cash flow hedges, and fair values as of September 30, 2017 and December 31, 2016.

(dollars in thousands)

Notional amount	Maturity date	Receive (variable) index	Pay fixed swap rate	Fair value	
				assets (liabilities) September 30, 2017	December 31, 2016
\$10,000	12/6/2021	US 3 Month LIBOR	1.89 %	\$ 26	\$ 16
20,000	12/6/2020	US 3 Month LIBOR	1.79 %	8	9
\$30,000			1.82 %	\$ 34	\$ 25

**(19) Regulatory Matters**

Bancorp and the Bank are subject to various capital requirements prescribed by banking regulations and administered by state and federal banking agencies. The final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The minimum capital level requirements applicable to banks and bank holding companies subject to the rules are:

- a total risk-based capital ratio of 8%
- a common equity tier 1 capital ratio of 4.5%
- a tier 1 risk-based capital ratio of 6%
- a tier 1 leverage ratio of 4%

Under these requirements, Bancorp and the Bank must meet minimum amounts and percentages of Tier 1 capital, common equity Tier 1 capital, and total capital to risk weighted assets, and Tier 1 capital to average assets. Risk weighted assets are determined by applying certain risk weightings prescribed by regulation to various categories of assets and off-balance sheet commitments. Capital and risk weighted assets may be further subject to qualitative judgments by regulators as to components, risk weighting and other factors. Failure to meet capital requirements can

result in certain mandatory, and possibly discretionary, corrective actions prescribed by regulation or determined to be necessary by regulators, which could materially affect the unaudited consolidated financial statements.

The Basel III rules also established a capital conservation buffer of 2.5%, to be phased in over three years through December 31, 2018, above the regulatory minimum risk-based capital ratios. When fully phased in the buffer will result in the following minimum ratios:

- a common equity tier 1 risk-based capital ratio of 7.0%,
- a tier 1 risk-based capital ratio of 8.5%, and
- a total risk-based capital ratio of 10.5%.

The rules allowed banks and their holding companies with less than \$250 billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. Bancorp opted out of this requirement.



Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

As of September 30, 2017, Bancorp meets the requirements to be considered well capitalized under the rules, and is not subject to limitations due to the capital conservation buffer.

The following tables set forth consolidated Bancorp's and the Bank's risk based capital amounts and ratios as of September 30, 2017 and December 31, 2016.

(dollars in thousands)	<b>Actual</b>		<b>Minimum for adequately capitalized</b>		<b>Minimum for well capitalized</b>	
	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
<b>September 30, 2017</b>						
Total risk-based capital (1)						
Consolidated	\$358,610	13.64%	\$210,328	8.00%	NA	NA
Bank	346,040	13.20	209,721	8.00	\$262,152	10.00%
Common equity tier 1 risk-based capital						
Consolidated	333,312	12.67	118,382	4.50	NA	NA
Bank	320,742	12.23	118,016	4.50	157,355	6.00
Tier 1 risk-based capital (1)						
Consolidated	333,312	12.67	157,843	6.00	NA	NA
Bank	320,742	12.23	157,355	6.00	157,355	6.00
Leverage (2)						
Consolidated	333,312	11.02	120,984	4.00	NA	NA
Bank	320,742	10.61	120,921	4.00	151,151	5.00

(dollars in thousands)	<b>Actual</b>		<b>Minimum for adequately</b>	<b>Minimum for well</b>
------------------------	---------------	--	-------------------------------	-------------------------

December 31, 2016			capitalized		capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total risk-based capital (1)						
Consolidated	\$338,525	13.04%	\$207,684	8.00%	NA	NA
Bank	325,630	12.57	207,243	8.00	\$259,053	10.00%
Common equity tier 1 risk-based capital						
Consolidated	314,147	12.10	116,832	4.50	NA	NA
Bank	301,252	11.63	116,564	4.50	155,418	6.00
Tier 1 risk-based capital (1)						
Consolidated	314,147	12.10	155,775	6.00	NA	NA
Bank	301,252	11.63	155,418	6.00	155,418	6.00
Leverage (2)						
Consolidated	314,147	10.54	119,221	4.00	NA	NA
Bank	301,252	10.11	119,190	4.00	148,987	5.00

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

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

NA Not applicable. Regulatory framework does not define well capitalized for holding companies.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary****(20) Segments**

Bancorp's principal activities include commercial banking and wealth management and trust (WM&T). Commercial banking provides a full range of loan and deposit products to individual consumers and businesses. Commercial banking also includes Bancorp's mortgage origination and securities brokerage activity. WM&T provides financial management services including investment management, trust and estate administration, and retirement plan services.

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

Principally, all of the net assets of Stock Yards Bancorp, Inc. are involved in the commercial banking segment. Bancorp has goodwill of \$682,000 related to a bank acquisition in 1996 which has been assigned to the commercial banking segment. Assets assigned to WM&T consist of premises and equipment, net of accumulated depreciation.

Selected financial information by business segment for the three and nine month periods ended September 30, 2017 and 2016 follows:

(in thousands)	<b>Commercial banking</b>	<b>Wealth management and trust</b>	<b>Total</b>
<b>Three months ended September 30, 2017</b>			
Net interest income	\$ 26,089	\$ 75	\$26,164
Provision for loan losses	150	-	150
Wealth management and trust services	-	5,025	5,025
All other non-interest income	6,078	-	6,078
Non-interest expense	18,491	2,826	21,317
Income before income taxes	13,526	2,274	15,800
Income tax expense	3,284	812	4,096

Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Net income	\$ 10,242	\$ 1,462	\$ 11,704
Segment assets	\$ 3,153,886	\$ 2,027	\$ 3,155,913

**Three months ended September 30, 2016**

Net interest income	\$ 24,690	\$ 70	\$ 24,760
Provision for loan losses	1,250	-	1,250
Wealth management and trust services	-	4,800	4,800
All other non-interest income	6,558	-	6,558
Non-interest expense	17,722	2,796	20,518
Income before income taxes	12,276	2,074	14,350
Income tax expense	3,142	741	3,883
Net income	\$ 9,134	\$ 1,333	\$ 10,467
Segment assets	\$ 2,936,542	\$ 2,123	\$ 2,938,665

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

(in thousands)	<b>Commercial banking</b>	<b>Wealth management and trust</b>	<b>Total</b>
<b>Nine months ended September 30, 2017</b>			
Net interest income	\$ 76,350	\$ 230	\$76,580
Provision for loan losses	1,650	-	1,650
Wealth management and trust services	-	15,272	15,272
All other non-interest income	18,303	-	18,303
Non-interest expense	54,756	9,055	63,811
Income before income taxes	38,247	6,447	44,694
Income tax expense	9,295	2,302	11,597
Net income	\$ 28,952	\$ 4,145	\$33,097
Segment assets	\$ 3,153,886	\$ 2,027	\$3,155,913
<b>Nine months ended September 30, 2016</b>			
Net interest income	\$ 71,985	\$ 194	\$72,179
Provision for loan losses	2,500	-	2,500
Wealth management and trust services	-	14,219	14,219
All other non-interest income	17,999	-	17,999
Non-interest expense	51,914	8,337	60,251
Income before income taxes	35,570	6,076	41,646
Income tax expense	9,064	2,171	11,235
Net income	\$ 26,506	\$ 3,905	\$30,411
Segment assets	\$ 2,936,542	\$ 2,123	\$2,938,665

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

This item discusses results of operations for Stock Yards Bancorp, Inc. ("Bancorp" or "Company"), and its subsidiary, Stock Yards Bank & Trust Company ("Bank") for the three and nine months ended September 30, 2017 and compares these periods with the same periods of the previous year. Unless otherwise indicated, all references in this discussion to the Bank include Bancorp. In addition, the discussion describes changes in the financial condition of Bancorp and the Bank that have occurred during the first nine months of 2017 compared with same period in 2016. This discussion should be read in conjunction with the consolidated financial statements and accompanying notes presented in Part 1, Item 1 of this report.

This report contains forward-looking statements under the Private Securities Litigation Reform Act that involve risks and uncertainties. Although Bancorp believes assumptions underlying forward-looking statements contained herein are reasonable, any of these assumptions could be inaccurate. Factors that could cause actual results to differ from results discussed in forward-looking statements include, but are not limited to the following: economic conditions both generally and more specifically in markets in which Bancorp and the Bank operate; competition for Bancorp's customers from other providers of financial services; government legislation and regulation which change from time to time and over which Bancorp has no control; changes in interest rates; material unforeseen changes in liquidity, results of operations, or financial condition of Bancorp's customers; and other risks detailed in Bancorp's filings with the Securities and Exchange Commission, all of which are difficult to predict and many of which are beyond the control of Bancorp.

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

**Overview of 2017 through September 30, 2017**

Bancorp completed the first nine months of 2017 with net income of \$33.1 million, an 8.8% increase over the comparable period in 2016. The increase is primarily due to higher net interest income, higher non-interest income, and a reduction in provision for loan losses. These increases were partially offset by higher non-interest expense. Diluted earnings per share for the first nine months of 2017 were \$1.44, compared with \$1.34 for the first nine months of 2016. Bancorp's performance for the first nine months of 2017 reflected several positive factors, including:

- The continued positive effect of solid loan growth over the past 12 months, which has increased Bancorp's net interest income nearly 6% compared with that for the third quarter of 2016;
- A six basis point increase in net interest margin sequentially from the second quarter of 2017;
- A reduction in the provision for loan losses as credit quality remained excellent;
- Steady growth in fee income from the Wealth Management and Trust Group;
- A tax benefit from the wind-down of a tax-credit partnership; and
- Solid returns on average assets and equity.

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

Net interest income increased \$4.4 million, or 6.1%, for the first nine months of 2017, compared with the same period in 2016. Net interest margin increased to 3.63% for the first nine months of 2017, compared with 3.60% for the same period of 2016.

For the nine-month period ended September 30, 2017, Bancorp recorded a \$1.7 million provision for loan losses, compared to \$2.5 million for the same period in 2016. The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, is adequate to provide coverage for the inherent losses on outstanding loans.

Total non-interest income in the first nine months of 2017 increased \$1.4 million, or 4.2%, compared with the same period in 2016, and comprised 30.0% of total revenues, as compared to 31.6% for the same period in 2016. Continuing the trends of 2016, Bancorp's wealth management and trust department (WM&T) led the increase with a 7.4%, or \$1.1 million increase over the same period in 2016.

Total non-interest expense in the first nine months of 2017 increased \$3.6 million, or 5.9%, compared with the same period in 2016, primarily due to increases in salaries and employee benefits, as well as expenses related to the Bancorp's continued growth and improvements in technology infrastructure. Amortization expenses for investments in tax-credit partnerships, which had a significant impact on earnings in 2016, decreased by \$1.2 million, or 39.4%, in the first nine months of 2017 as compared to the same period in 2016. Bancorp's efficiency ratio in the first nine months of 2017 was 57.6% compared to 57.4% in the same period in 2016. Excluding amortization of the investments in tax credit partnerships, the adjusted efficiency ratio, a non-GAAP measure, would have been 55.9% and 54.5% for the first nine months of 2017 and 2016, respectively. See the Non-GAAP Financial Measures section for details on reconciliation to US GAAP measures.



Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Bancorp's effective tax rate decreased to 25.9% in 2017 from 27.0% in 2016. In 2017 Bancorp adopted ASU 2016-09 "Compensation – Stock Compensation Improvements to Employee Share-Based Payment Accounting". The new standard requires excess tax benefits and deficiencies related to share-based payment awards to be reflected in the statement of operations as a component of the provision for income taxes. For the nine months ended September 30, 2017 Bancorp recorded a benefit of \$1.4 million for such tax benefits against the provision for income tax expense. Prior to adoption of ASU 2016-09 these tax benefits were recorded directly to additional paid-in capital.

The ratio of shareholder's equity to total assets was 10.59% as of September 30, 2017 compared with 10.33% at December 31, 2016. Tangible common equity (TCE), a non-GAAP measure, is a measure of a company's capital which is useful in evaluating the quality and adequacy of capital. The ratio of tangible common equity to total tangible assets was 10.54% as of September 30, 2017, compared with 10.26% at December 31, 2016. See the Non-GAAP Financial Measures section for details on reconciliation to US GAAP measures.

In April 2016 Bancorp declared a 3 for 2 stock split effected as a 50% stock dividend payable in May 2016. Share and per share information has been adjusted for this dividend.

The following sections provide more details on Bancorp's financial condition and results of operation.

***a) Results Of Operations***

Net income of \$11.7 million for the three months ended September 30, 2017 increased \$1.2 million, or 11.8%, from \$10.5 million for the comparable 2016 period. Basic net income per share was \$0.52 for the third quarter of 2017, an increase of 10.6% from the \$0.47 for the third quarter of 2016. Net income per share on a diluted basis was \$0.51 for the third quarter of 2017, as compared to \$0.46 for the same period in 2016. See Note 11 for additional information related to net income per share.

Annualized return on average assets and annualized return on average stockholders' equity were 1.53% and 14.03%, respectively, for the third quarter of 2017, compared with 1.44% and 13.47%, respectively, for the same period in 2016.

## Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Net income of \$33.1 million for the nine months ended September 30, 2017 increased \$2.7 million, or 8.8%, from \$30.4 million for the comparable 2016 period. Basic net income per share was \$1.47 for the first nine months of 2017, an increase of 8.1% from the \$1.36 for the period in 2016. Net income per share on a diluted basis was \$1.44 for the first nine months of 2017, an increase of 7.5% from the \$1.34 for the same period in 2016. See Note 11 for additional information related to net income per share.

Annualized return on average assets and annualized return on average stockholders' equity were 1.47% and 13.65%, respectively, for the first nine months of 2017, compared with 1.42% and 13.51%, respectively, for the same period in 2016.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary****Net Interest Income**

The following table presents average balance sheets for the three and nine month periods ended September 30, 2017 and 2016 along with the related calculation of tax-equivalent net interest income, net interest margin and net interest spread for the related periods. See the notes following the tables for further explanation.

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

(Dollars in thousands)	<b>Three months ended September 30,</b>						
	<b>2017</b>			<b>2016</b>			
	<b>Average</b>	<b>Interest</b>	<b>Average</b>	<b>Average</b>	<b>Interest</b>	<b>Average</b>	
	<b>balances</b>		<b>rate</b>	<b>balances</b>		<b>rate</b>	
<b>Earning assets:</b>							
Federal funds sold and interest bearing deposits	\$120,927	\$388	1.27 %	\$72,673	\$95	0.52 %	
Mortgage loans held for sale	3,515	48	5.42	5,070	66	5.18	
Securities:							
Taxable	387,696	1,920	1.96	406,481	1,984	1.94	
Tax-exempt	51,905	388	2.97	59,981	426	2.83	
FHLB stock and other securities	7,666	83	4.30	6,347	63	3.95	
Loans, net of unearned income	2,289,435	25,484	4.42	2,171,772	23,511	4.31	
<b>Total earning assets</b>	<b>2,861,144</b>	<b>28,311</b>	<b>3.93</b>	<b>2,722,324</b>	<b>26,145</b>	<b>3.82</b>	
Less allowance for loan losses	25,434			23,634			
	2,835,710			2,698,690			
Non-earning assets:							
Cash and due from banks	41,550			41,682			
Premises and equipment	41,395			42,665			
Accrued interest receivable and other assets	108,433			100,109			
<b>Total assets</b>	<b>\$3,027,088</b>			<b>\$2,883,146</b>			
<b>Interest bearing liabilities:</b>							
Deposits:							
Interest bearing demand deposits	\$725,822	\$418	0.23 %	\$698,874	\$232	0.13 %	
Savings deposits	150,332	55	0.15	136,292	11	0.03	
Money market deposits	691,726	741	0.43	655,912	346	0.21	
Time deposits	232,773	379	0.65	247,237	352	0.57	

Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Securities sold under agreements to repurchase	73,806	33	0.18	68,835	38	0.22
Federal funds purchased and other short term borrowings	27,535	77	1.11	23,471	19	0.32
FHLB advances	50,221	244	1.93	44,194	184	1.66
<b>Total interest bearing liabilities</b>	<b>1,952,215</b>	<b>1,947</b>	<b>0.40</b>	<b>1,874,815</b>	<b>1,182</b>	<b>0.25</b>
<b>Non-interest bearing liabilities:</b>						
Non-interest bearing demand deposits	697,815			656,689		
Accrued interest payable and other liabilities	46,194			42,597		
<b>Total liabilities</b>	<b>2,696,224</b>			<b>2,574,101</b>		
<b>Stockholders' equity</b>	<b>330,864</b>			<b>309,045</b>		
<b>Total liabilities and stockholders' equity</b>	<b>\$3,027,088</b>			<b>\$2,883,146</b>		
<b>Net interest income</b>		<b>\$26,364</b>			<b>\$24,963</b>	
<b>Net interest spread</b>			<b>3.53 %</b>			<b>3.57 %</b>
<b>Net interest margin</b>			<b>3.66 %</b>			<b>3.65 %</b>

Table of Contents**Stock Yards Bancorp, inc. and subsidiary****Average Balances and Interest Rates - Taxable Equivalent Basis**

(Dollars in thousands)	Nine months ended September 30,						
	2017			2016			
	Average balances	Interest	Average rate	Average balances	Interest	Average rate	
<b>Earning assets:</b>							
Federal funds sold and interest bearing deposits	\$97,543	\$798	1.09	% \$100,653	\$395	0.52	%
Mortgage loans held for sale	3,656	145	5.30	4,918	185	5.02	
Securities:							
Taxable	406,476	5,944	1.96	413,508	6,135	1.98	
Tax-exempt	53,568	1,186	2.96	61,417	1,298	2.82	
FHLB stock and other securities	6,801	229	4.50	6,347	190	4.00	
Loans, net of unearned income	2,275,320	74,055	4.35	2,113,744	68,238	4.31	
<b>Total earning assets</b>	<b>2,843,364</b>	<b>82,357</b>	<b>3.87</b>	<b>2,700,587</b>	<b>76,441</b>	<b>3.78</b>	
Less allowance for loan losses	24,891			23,057			
	2,818,473			2,677,530			
Non-earning assets:							
Cash and due from banks	40,547			40,097			
Premises and equipment	41,798			41,500			
Accrued interest receivable and other assets	106,035			94,263			
<b>Total assets</b>	<b>\$3,006,853</b>			<b>\$2,853,390</b>			
<b>Interest bearing liabilities:</b>							
Deposits:							
Interest bearing demand deposits	\$739,295	\$1,076	0.19	% \$710,417	\$735	0.14	%
Savings deposits	147,471	123	0.11	134,004	35	0.03	
Money market deposits	693,656	1,968	0.38	652,406	1,060	0.22	
Time deposits	239,250	1,070	0.60	254,172	1,086	0.57	
Securities sold under agreements to repurchase	67,556	100	0.20	60,438	100	0.22	
Federal funds purchased and other short term borrowings	20,581	125	0.81	25,021	57	0.30	
FHLB advances	50,541	715	1.89	43,533	552	1.69	
<b>Total interest bearing liabilities</b>	<b>1,958,350</b>	<b>5,177</b>	<b>0.35</b>	<b>1,879,991</b>	<b>3,625</b>	<b>0.26</b>	
<b>Non-interest bearing liabilities:</b>							
Non-interest bearing demand deposits	680,831			637,812			
Accrued interest payable and other liabilities	43,437			34,844			
<b>Total liabilities</b>	<b>2,682,618</b>			<b>2,552,647</b>			

<b>Stockholders' equity</b>	324,235			300,743		
<b>Total liabilities and stockholders' equity</b>	\$3,006,853			\$2,853,390		
<b>Net interest income</b>		\$77,180			\$72,816	
<b>Net interest spread</b>			3.52 %			3.52 %
<b>Net interest margin</b>			3.63 %			3.60 %

47

---

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Notes to the average balance and interest rate tables:

Net interest income, the most significant component of the Bank's earnings is total interest income less total interest expense. The level of net interest income is determined by mix and volume of interest earning assets, interest bearing deposits and borrowed funds, and changes in interest rates.

Net interest spread is the difference between taxable equivalent rates earned on interest earning assets less the rate expensed on interest bearing liabilities.

Net interest margin represents net interest income on a taxable equivalent basis as a percentage of average interest earning assets. Net interest margin is affected by both interest rate spread and the level of non-interest bearing sources of funds, primarily consisting of demand deposits and stockholders' equity.

Interest income on a fully tax equivalent basis includes additional amounts of interest income that would have been earned if investments in certain tax-exempt interest earning assets had been made in assets subject to federal taxes yielding the same after-tax income. Interest income on municipal securities and tax-exempt loans has been calculated on a fully tax equivalent basis using a federal income tax rate of 35%. Approximate tax equivalent adjustments to interest income were \$199 thousand and \$203 thousand, respectively, for the three month periods ended September 30, 2017 and 2016 and \$599 thousand and \$637 thousand, respectively, for the nine month periods ended September 30, 2017 and 2016.

Average balances for loans include the principal balance of non-accrual loans and exclude participation loans accounted for as secured borrowings. These participation loans averaged \$19.4 million and \$16.3 million, respectively, for the three month periods ended September 30, 2017 and 2016 and \$18.9 million and \$11.2 million, respectively, for the nine month periods ended September 30, 2017 and 2016.

Fully taxable equivalent net interest income of \$26.4 million for the three months ended September 30, 2017 increased \$1.4 million, or 5.6%, from \$25.0 million for the same period in 2016. Bancorp recognized positive effects of increased average balances on loans, resulting from loan growth in 2016, and increased rates on all earning asset categories following rate increases by the Federal Reserve, were partially offset by the negative effect of increased rates for all funding sources, and increased average balances for all funding sources except certificate of deposit accounts. To date in 2017 the Federal Reserve twice raised the target Fed Funds rate with 25 basis point increases in both March and June. Management increased rates paid on retail deposits accounts in conjunction with the March rate hike. Those deposit customers had not seen a rate increase on their accounts in over ten years. The June increase resulted in most of the variable rate loan portfolio breaking through applicable floor rates which will enhance margin

going forward. Net interest spread and net interest margin were 3.53% and 3.66%, respectively, for the third quarter of 2017 and 3.57% and 3.65%, respectively, for the third quarter of 2016. Heightened competition on pricing, effects of liquidity and a flattening yield curve contributed to pressure on net interest margin.

Fully taxable equivalent net interest income of \$77.2 million for the nine months ended September 30, 2017 increased \$4.4 million, or 6.0%, from \$72.8 million for the same period in 2016. Positive effects of increased average balances on loans, resulting from loan growth in 2016, and increased rates on other earning assets, were partially offset by the negative effect of increasing rates and average balances for all funding sources except certificates of deposits. Average rates on loans increased period to period while the rates on taxable securities decreased. Net interest spread and net interest margin were 3.52% and 3.63%, respectively, for the first nine months of 2017 and 3.52% and 3.60%, respectively, for the first nine months of 2016.



Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Average earning assets increased \$138.8 million or 5.1% to \$2.9 billion for the three month period ended September 30, 2017 as compared to the same time period in 2016, reflecting growth in the loan portfolio and to a lesser extent fed funds sold. Average interest bearing liabilities increased \$77 million or 4.1% for the third quarter of September 30, 2017 as compared to the third quarter of 2016. A decrease in volume of time deposits partially offset increases in all other interest bearing deposit and borrowing categories. Average earning assets increased \$142.8 million or 5.3%, to \$2.8 billion for the first nine months of 2017 as compared with 2016, reflecting increases in the loan portfolio, the majority of which was garnered in 2016. Average interest bearing liabilities increased \$78.4 million, or 4.1%, to \$1.95 billion for the first nine months of 2017, as compared with the same period in 2016. Increases in the volume of interest bearing demand deposits, savings deposits, money market deposit accounts, securities sold under agreements to repurchase, and FHLB advances, were partially offset by decreases in volume of time deposits, and other short term borrowing products.

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

Managing interest rate risk is fundamental for the financial services industry. The primary objective of interest rate risk management is to neutralize effects of interest rate changes on net income. By considering both on and off-balance sheet financial instruments, management evaluates interest rate sensitivity with the goal of optimizing net interest income within the constraints of prudent capital adequacy, liquidity needs, market opportunities and customer requirements.

**Interest Rate Simulation Sensitivity Analysis**

Bancorp uses an earnings simulation model to estimate and evaluate the impact of an immediate change in interest rates on earnings in a one year forecast. The simulation model is designed to reflect dynamics of interest earning assets, interest bearing liabilities and off-balance sheet financial instruments. By estimating effects of interest rate increases and decreases, the model can reveal approximate interest rate risk exposure. This simulation model is used by management to gauge approximate results given a specific change in interest rates at a given point in time. The model is therefore a tool to indicate earnings trends in given interest rate scenarios and may not indicate actual expected results.

The September 30, 2017 simulation analysis, which shows minimal interest rate sensitivity, indicates that Bancorp is asset sensitive as increases in interest rates of 100 to 200 basis points have a positive effect on net interest income. If

rates raise 200 basis points, net interest income would increase 2.12%. The excess liquidity held in interest bearing deposit accounts and other short-term investments along with variable rate loans now at or above their floors gives Bancorp significant assets that will reprice as rates move. Those same balances cause an estimated decline in net interest income in a down 100 basis point rate scenario. These estimates are summarized below.

	<b>Net interest income % change</b>
Increase 200 bp	2.12
Increase 100 bp	1.03
Decrease 100 bp	(4.27)
Decrease 200 bp	(11.10)

Approximately 61% of Bancorp's loan portfolio has fixed rates and 39% of its loan portfolio is priced at variable rates. With the Prime rate currently at 4.25%, and after the .25% increase in Prime in June of 2017, the majority of Bancorp's variable rate loans now have interest rates at or above their floors.

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Undesignated derivative instruments described in Note 18 to Bancorp's consolidated financial statements are recognized on the consolidated balance sheet at fair value, with changes in fair value due to changes in prevailing interest rates, recorded in other non-interest income. Because of matching terms of offsetting contracts, in addition to collateral provisions which mitigate the impact of non-performance risk, changes in fair value subsequent to initial recognition have a minimal effect on earnings, and are therefore not included in the simulation analysis results above.

Derivatives designated as cash flow hedges described in Note 18 to Bancorp's consolidated financial statements are recognized on the consolidated balance sheet at fair value, with changes in fair value due to changes in prevailing interest rates, recorded net of tax in other comprehensive income.

**Provision for Loan Losses**

The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, is adequate to provide coverage for inherent losses on outstanding loans. The allowance for loan losses is calculated after considering credit quality factors, and ultimately relies on an overall internal analysis of risk in the loan portfolio. The provision reflects an allowance methodology that is driven by risk ratings, historical losses, and qualitative factors. The provision for the first nine months of 2017, and the resulting allowance level, reflected a number of factors, including stable and acceptable credit quality metrics, modest loan growth during the period, and an expansion of the historical look-back period from 24 quarters to 28 quarters. This expansion of the look-back period was applied to all classes and segments of the portfolio. The expansion of the look-back period for the historical loss rates used in the quantitative allocation caused management to review the overall methodology for the qualitative factors to ensure Bancorp was appropriately capturing the risk not addressed in the historical loss rates used in the quantitative allocation, resulting in the same expansion of the look-back period for the qualitative factors. Management believes the extension of the look-back period is appropriate to ensure capture of the impact of a full economic cycle and more accurately represents the current level of risk inherent in the loan portfolio. Key indicators of loan quality continued to show improvement during 2017, with levels of non-performing loans continuing a five year downward trend. Classified assets, after experiencing a slight elevation the prior quarter stabilized in the third quarter. Bancorp recorded provision for loan losses of \$150 thousand and \$1.7 million for the first three and nine month periods of 2017, respectively, as compared to \$1.3 million and \$2.5 million for the same periods in 2016.

Management uses loan grading procedures which result in specific allowance allocations for estimated inherent risk of loss. For all loans graded, but not individually reviewed for allowance purposes, a general allowance allocation is computed using historical data based on actual loss experience. Specific and general allocations plus consideration of qualitative factors represent management's best estimate of probable losses contained in the loan portfolio at the

evaluation date. Although the allowance for loan losses is comprised of specific and general allocations, the entire allowance is available to absorb any credit losses. Based on this detailed analysis of credit risk, management considers the allowance for loan losses adequate to cover probable losses inherent in the loan portfolio at September 30, 2017.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

An analysis of the changes in the allowance for loan losses and selected ratios for the three and nine month periods ended September 30, 2017 and 2016 follows:

(dollars in thousands)	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>	<b>2016</b>	<b>September 30,</b>	<b>2016</b>
Balance at the beginning of the period	\$25,115	\$23,141	\$24,007	\$22,441
Provision for loan losses	150	1,250	1,650	2,500
Loan charge-offs, net of recoveries	(317 )	(22 )	(709 )	(572 )
Balance at the end of the period	\$24,948	\$24,369	\$24,948	\$24,369
Average loans, net of unearned income	\$2,289,436	\$2,188,089	\$2,275,320	\$2,124,921
Provision for loan losses to average loans (1)	0.01	% 0.06	% 0.07	% 0.12
Net loan charge-offs to average loans (1)	0.01	% 0.00	% 0.03	% 0.03
Allowance for loan losses to average loans	1.09	% 1.11	% 1.09	% 1.15
Allowance for loan losses to period-end loans	1.07	% 1.10	% 1.07	% 1.10

(1) Amounts not annualized

Loans are charged off when deemed uncollectible and a loss is identified or after underlying collateral has been liquidated; however, collection efforts may continue and future recoveries may occur. Periodically, loans are partially charged off to net realizable value based upon collateral analysis and collection status.

An analysis of net charge-offs by loan category for the three and nine month periods ended September 30, 2017 and 2016 follows:

(in thousands)	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>	<b>2016</b>	<b>September 30,</b>	<b>2016</b>
<b>Net loan charge-offs (recoveries)</b>				
Commercial and industrial	\$280	\$18	\$642	\$375
Construction and development, excluding undeveloped land	-	(11)	-	(21)

Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

Undeveloped land	-	-	-	-
Real estate mortgage - commercial investment	(16 )	(67 )	(52 )	(226)
Real estate mortgage - owner occupied commercial	-	(9 )	-	305
Real estate mortgage - 1-4 family residential	(1 )	64	(5 )	63
Home equity	(5 )	(34)	4	(34 )
Consumer	59	61	120	110
<b>Total net loan charge-offs (recoveries)</b>	<b>\$317</b>	<b>\$22</b>	<b>\$709</b>	<b>\$572</b>

Table of Contents**Stock Yards Bancorp, inc. and subsidiary****Non-interest Income and Expenses**

The following table sets forth major components of non-interest income and expenses for the three and nine month periods ended September 30, 2017 and 2016.

(In thousands)	Three months ended September 30,			Nine months ended September 30,		
	2017	2016	% Change	2017	2016	% Change
Non-interest income:						
Wealth management and trust services	\$5,025	\$4,800	4.7 %	\$15,272	\$14,219	7.4 %
Service charges on deposit accounts	2,522	2,544	(0.9 )	7,368	6,952	6.0
Bankcard transactions	1,492	1,455	2.5	4,412	4,198	5.1
Mortgage banking	781	1,072	(27.1 )	2,380	2,896	(17.8 )
Gain (loss) on calls of securities available for sale	31	-	0.0	31	-	0.0
Securities brokerage	551	558	(1.3 )	1,584	1,539	2.9
Bank owned life insurance	204	216	(5.6 )	964	657	46.7
Other	497	713	(30.3 )	1,564	1,757	(11.0 )
Total non-interest income	\$11,103	\$11,358	(2.2 )%	\$33,575	\$32,218	4.2 %
Non-interest expenses:						
Salaries and employee benefits	\$12,983	\$12,048	7.8 %	\$39,244	\$36,214	8.4 %
Net occupancy	1,621	1,646	(1.5 )	4,765	4,716	1.0
Data processing	1,920	1,747	9.9	5,909	5,172	14.2
Furniture and equipment	316	277	14.1	861	853	0.9
FDIC insurance	242	356	(32.0 )	716	1,035	(30.8 )
Amortization of investment in tax credit partnerships	616	1,015	(39.3 )	1,847	3,046	(39.4 )
Other	3,619	3,429	5.5	10,469	9,215	13.6
Total non-interest expenses	\$21,317	\$20,518	3.9 %	\$63,811	\$60,251	5.9 %

The largest component of non-interest income is wealth management and trust (“WM&T”) revenue. The magnitude of WM&T revenue distinguishes Bancorp from most other community banks of similar asset size. WM&T assets under management (AUM) totaled \$2.7 billion at September 30, 2017, a 12.5% increase compared to \$2.4 billion at

September 30, 2016. AUM are stated at market value and while the 2017 increase was partially the result of a rising stock market during the period, primarily it represents a continuance of the 2016 trend for new clients added. WM&T revenue, which constitutes an average of 45% of non-interest income, increased \$225 thousand, or 4.7% and \$1.1 million or 7.4% for the three and nine month periods ended September 30, 2017 respectively, compared to the same periods in 2016. Recurring fees, which generally comprise over 98% of the WM&T revenue, increased \$340 thousand or 7.4% and \$1.4 million, or 10.7%, for the respective three and nine month periods ended September 30, 2017, as compared to the same periods in 2016. Recurring fees earned for managing accounts are based on a percentage of market value of AUM and are assessed on a monthly basis. Some revenues of WM&T, most notably executor, insurance, and some employee benefit plan-related fees, are non-recurring in nature and the timing of these revenues corresponds with the related administrative activities, and is also based on the market value of AUM. Total non-recurring fees decreased \$115 thousand and \$393 thousand for the three and nine months ended September 30, 2017, compared to the same periods in 2016, primarily due to a decrease in estate fees period to period. Contracts between WM&T and their clients do not permit performance based fees and, accordingly, none of the fees earned by WM&T are performance based. Management believes WM&T will continue to factor significantly in Bancorp's financial results and provide strategic diversity to revenue streams.



Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

The following table provides information regarding AUM by WM&T as of September 30, 2017 and 2016. This table demonstrates that:

- Approximately 80% of WM&T's assets are actively managed.
- Corporate retirement plan accounts consist primarily of participant directed assets.
- The amount of custody and safekeeping accounts is insignificant, and
- The majority of WM&T's managed assets are in personal trust and investment advisory accounts.

**Assets Under Management by Account Type**

	<b>September 30, 2017</b>		<b>September 30, 2016</b>	
	<b>Assets</b>	<b>Non-</b>	<b>Assets</b>	<b>Non-</b>
(in thousands)	<b>Managed</b>	<b>managed</b>	<b>Managed</b>	<b>managed</b>
		<b>(1)</b>		<b>(1)</b>
Personal trust accounts	\$567,222	\$96,005	\$512,905	\$62,221
Personal investment retirement accounts	340,159	7,142	311,215	10,024
Corporate retirement accounts	56,515	382,803	53,190	335,613
Investment advisory accounts	995,769	20,169	867,776	-
Foundation and endowment accounts	220,722	-	224,213	-
<b>Total fiduciary accounts</b>	<b>\$2,180,387</b>	<b>\$506,119</b>	<b>\$1,969,299</b>	<b>\$407,858</b>
Custody and safekeeping accounts	-	59,490	-	35,773
<b>Totals</b>	<b>\$2,180,387</b>	<b>\$565,609</b>	<b>\$1,969,299</b>	<b>\$443,631</b>
<b>Total managed and non-managed assets</b>	<b>\$2,745,996</b>		<b>\$2,412,930</b>	

(1) Non-managed assets represent those for which WM&T does not have investment discretion.



Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

The table below presents data regarding WM&T managed assets by class of investment for the periods ending September 30, 2017 and 2016. This table demonstrates that:

- Managed assets are invested in instruments for which market values can be readily determined.
- The majority of these instruments are sensitive to market fluctuations.
- The composition of WM&T's managed assets is divided approximately 60% in equities and 40% in fixed income securities, and this composition is relatively consistent from year to year, and
- No Stock Yards Bank propriety mutual funds exist, and therefore no such investment options are available to WM&T clients.

**Managed Assets by Class of Investment**

(in thousands)	As of September 30,	
	2017	2016
Interest bearing deposits	\$ 122,787	\$ 127,570
US Treasury and government agency obligations	42,293	50,020
State, county and municipal obligations	132,431	126,394
Money market mutual funds	8,211	13,718
Equity mutual funds	548,972	453,995
Other mutual funds - fixed, balanced, and municipal	310,779	319,240
Other notes and bonds	120,155	88,463
Common and preferred stocks	795,732	688,543
Real estate mortgages	373	392
Real estate	43,664	44,572
Other miscellaneous assets (1)	54,990	56,392
Total managed assets	\$2,180,387	\$ 1,969,299

(1) Includes rights, warrants, annuities, insurance policies, unit investment trusts, and oil and gas rights.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

The table below provides information regarding fee income earned by Bancorp's WM&T department for the three and nine-month periods ended September 30, 2017 and 2016. It demonstrates that WM&T fee revenue is earned most significantly from personal trust and investment advisory accounts. Fees are based on AUM and tailored for individual accounts and/or relationships. WM&T uses a fee structure that considers and tailors based on type of account and other factors. For example, fee structures are in place for investment management, irrevocable trusts, revocable trusts, IRA accounts, and accounts holding only fixed income securities. There are also fee structures for estate settlements, which are non-recurring, and retirement plan services which typically consist of a one-time conversion fee with recurring AUM fees to follow. All fees are based on the market value of each account and are tiered based on account size. Fees are agreed upon at the time the account is opened and these and any subsequent revisions are communicated in writing to the customer. Fees earned are not performance based nor are they based on investment strategy or transactions.

**Wealth Management and Trust Services Income**

(In thousands)	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30, 2017</b>	<b>2016</b>	<b>September 30, 2017</b>	<b>2016</b>
Personal trust accounts	\$1,691	\$1,707	\$5,523	\$5,427
Personal retirement accounts	832	778	2,426	2,229
Corporate retirement accounts	373	408	1,161	1,162
Investment advisory accounts	1,895	1,681	5,471	4,789
Foundation and endowment	135	126	400	364
Custody and safekeeping	36	27	119	73
Brokerage and insurance	9	13	28	35
Other	54	60	144	140
<b>Total</b>	<b>\$5,025</b>	<b>\$4,800</b>	<b>\$15,272</b>	<b>\$14,219</b>

**Other Non-interest Income and Non-interest Expense**

Service charges on deposit accounts decreased \$22 thousand or 1% while increasing \$416 thousand, or 6.0%, for the three and nine month periods of 2017, respectively, as compared with the same periods in 2016. The decline quarter over quarter was driven by a decline in fees assessed on overdrawn checking accounts. This component of service charge income is generally driven by transaction volume, which can fluctuate throughout the year. Cash management

services offered to commercial customers through our treasury management area continues to be a growing source of revenue. Treasury generated gross revenue grew 12% over the nine month period ended September 30, 2017, as compared to the same period in 2016. Fees charged on overdrawn checking accounts declined 4% year over year. Management expects this source of revenue to slowly decline due to changes in customer behavior and ongoing regulatory restrictions. Service charges were further impacted by the introduction of a new checking account product in the third quarter of 2016. The product provides ancillary services to customers, while carrying a monthly service charge. The income associated with the new checking account product was approximately \$641 thousand for the first nine months of 2017, as compared to \$198 thousand for the same period in 2016.

Bankcard transaction revenue increased \$37 thousand or 2.5% for the third quarter of 2017, and \$214 thousand, or 5.1% for the first nine months of 2017, as compared as compared with the same periods in 2016. Bankcard transaction revenue primarily represents income the Bank derives from customers' use of debit and credit cards. Bancorp began offering credit cards to business customers late in 2015. Revenue on credit cards totaled \$276 thousand and \$795 thousand for the three and nine month periods of 2017, respectively, compared to \$206 thousand and \$520 thousand for the same periods in 2016. Bancorp expects volume of credit card transactions to increase as this product is expanded within the commercial customer base. Interchange income on debit cards declined \$35 thousand and \$66 thousand in the three and nine month periods of 2017, respectively, compared to the same periods in 2016. Bancorp expects future decreases in interchange rates on debit cards as merchants structure their technology and processes to take advantage of lower transactional pricing options, which do not favor Bancorp or the banking industry as a whole.

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Mortgage banking revenue primarily includes gains on sales of mortgage loans. Bancorp's mortgage banking department originates residential mortgage loans to be sold in the secondary market. Interest rates on the loans sold are locked with the borrower and investor prior to closing the loans, thus Bancorp bears no interest rate risk related to these loans. The department offers conventional, VA and FHA financing, for purchases and refinances, as well as programs for first-time home buyers. Changes in interest rates on mortgage loans directly impact the volume of business transacted by the mortgage banking department. Mortgage banking revenue decreased \$291 thousand or 27.1% and \$516 thousand, or 17.8%, for the respective three and nine month periods ended September 30, 2017 as compared with the same periods in 2016, primarily due to lower transaction volume. In Bancorp's primary market of Louisville, Kentucky the housing inventory was low, particularly in the first half of 2017, contributing to this decline.

Securities brokerage commissions and fees decreased \$7 thousand or 1.3% while increasing \$45 thousand, or 2.9%, for the respective three and nine month periods ended September 30, 2017 as compared with the same periods in 2016. Revenue fluctuations correspond primarily to overall brokerage volume. Brokerage commissions and fees earned consist primarily of stock, bond and mutual fund sales as well as wrap fees on accounts. Wrap fees are charges for investment programs that bundle together a suite of services, such as brokerage, advisory, research and management, and are based on a percentage of assets. Bancorp deploys its brokers primarily through its branch network via an arrangement with a third party broker-dealer, while larger managed accounts are serviced in the Bank's WM&T department.

Bank Owned Life Insurance (BOLI) income totaled \$204 thousand for the third quarter and \$964 thousand for the first nine months of 2017, as compared to \$216 thousand and \$657 thousand for the same periods in 2016. The year to date increase in 2017 over 2016, was primarily due to \$348 thousand in death benefit proceeds recorded in the second quarter of 2017. BOLI assets represent the cash surrender value for life insurance policies on certain current and prior employees who provided consent for Bancorp to be the beneficiary of a portion of such policies. BOLI income results from the related change in cash surrender value and any death benefits received under the policies. This income helps offset the cost of various employee benefits.

Other non-interest income decreased \$216 thousand or 30.3% and \$193 thousand, or 11%, for the respective three and nine month periods ended September 30, 2017 compared with the same periods in 2016. The primary driver of the decline was swap fee income, which declined \$116 thousand in the third quarter and \$251 thousand for the first nine months of 2017, as compared with the same periods in 2016. These fees are an infrequent source of revenue due to the unique nature of the transactions. This category contains a variety of other income sources none of which resulted in individually significant variances.

Salaries and employee benefits increased \$935 thousand or 7.8% for the third quarter of 2017, and \$3.0 million, or 8.4%, for the first nine months of 2017, as compared with the same periods in 2016. The increases are largely due to higher compensation expenses, reflecting addition of personnel and to a lesser extent, increased health care costs. The additions to staff were driven by expanding market presence in Cincinnati and Indianapolis, along with the need for front line lending and loan support staff across all markets. The Bank's employee health insurance is a self-insured plan and related expenses fluctuate with claims experience. At September 30, 2017, Bancorp had 581 full-time equivalent employees compared with 558 at September 30, 2016.

Net occupancy expense decreased \$25 thousand or 1.5% for the third quarter and increased \$49 thousand or 1.0% for the nine months ended September 30, 2017, as compared with the same periods in 2016. The quarterly decrease was the result of timing of normal maintenance activities. The increase year over year was largely due to increased recurring expenses for multiple bank properties and a decrease in sub-lease rents.

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Data processing expense increased \$173 thousand or 9.9% in the third quarter of 2017 and \$737 thousand, or 14.2% in the first nine months of 2017, as compared with the same periods in 2016. The increase was primarily a result of increases in computer infrastructure and maintenance costs. These expenses include ongoing computer software amortization, equipment depreciation, and expenditures related to investments in technology needed to maintain and improve the quality of delivery channels and internal resources.

Furniture and equipment expense increased \$39 thousand or 14.1% in the third quarter of 2017 and \$8 thousand or 0.9% for the first nine months of 2017, as compared with the same periods in 2016. Costs of capital asset additions flow through the statement of income over the lives of the assets in the form of depreciation expense.

FDIC insurance expense decreased \$114 thousand or 32% and \$319 thousand, or 30.7%, for the respective three and nine month periods of 2017, as compared with the same periods in 2016. The expense assessment is calculated by the FDIC on a quarterly basis. During 2016 the FDIC revised the assessment criteria to more closely align FDIC insurance expense with each financial institution's risk profile. Bancorp benefited from this change.

Amortization of investments in tax credit partnerships decreased \$399 thousand for the third quarter of 2017 and \$1.2 million for the first nine months of 2017, as compared with the same periods of 2016. This expense reflects amortization of investments in partnerships which generate federal income tax credits and vary widely depending upon the timing and magnitude of investments and related amortization. For each of Bancorp's investments in tax credit partnerships the tax benefit compared with the amortization results in a positive effect on net income. See the Income Taxes section below for details on amortization and income tax impact for these credits.

Other non-interest expenses increased \$190 thousand or 5.5% and \$1.3 million or 13.6% in the respective three and nine month periods ending September 30, 2017, as compared with the same periods in 2016. The quarterly increase was largely due to recording a \$266 thousand liability related to an estimated loss from certain administrative proceedings arising in the course of our business. The increase for the year to date 2017 period was largely due to a combination of numerous items, the largest of which are detailed below:

\$382 thousand of net recoveries on sales of foreclosed assets in 2016 compared with a net recovery in 2017 of \$39 thousand.



Legal and professional fees increased \$351 thousand primarily as a result of expenses associated with elevated collection efforts on impaired credits.

Local Franchise taxes based upon deposit balances which Bancorp pays in lieu of income taxes in Kentucky and Ohio, were up \$174 thousand during the nine month period. Deposit growth drove the increased expense.

As described above, during 2016 Bancorp introduced a checking product that offers benefits to account owners. The expense associated with the product totaled \$145 thousand for the first nine months of 2017 as opposed to \$28 thousand for the same period in 2016.

Losses relating to check and debit card fraud increased \$84 thousand for the first nine months of 2017 over the same period in 2016.

In the third quarter of 2017 we recorded a \$266 thousand liability related to an estimated loss from certain administrative proceedings arising in the course of our business.

Other non-interest expenses also include other insurance, advertising, printing, mail and telecommunications, none of which had individually significant variances.

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

**Income Taxes**

Bancorp recorded income tax expense of \$4.1 million and \$11.6 million for the three and nine month periods ended September 30, 2017, respectively, as compared with \$3.9 million and \$11.2 million for the same periods in 2016. The effective rate for both the three and nine months ended September 30, 2017, was 25.9% in 2017 as compared to 27.1% and 27.0% for the three and nine months ended September 30, 2016, respectively. Refer to Footnote 5 to the consolidated financial statements for a reconciliation of the statutory and effective income tax rates.

Bancorp invests in certain partnerships with customers that yield federal income tax credits, and these tax credits reduce the effective tax rate. The level of this activity for the first nine months of 2017 was less than that of the comparable period in 2016 as is reflected in the comparable effect on effective tax rates for those periods. Taken as a whole, the tax benefit of these investments exceeds amortization expense associated with them, resulting in a positive impact on net income.

The effective tax rate in 2017 was largely reduced by the result of the adoption of ASU 2016-09 “Compensation – Stock Compensation Improvements to Employee Share-Based Payment Accounting”. The new standard requires excess tax benefits and deficiencies related to share-based payment awards to be reflected in the statement of operations as a component of the provision for income taxes. For the three and nine months ended September 30, 2017 Bancorp recorded a benefit of \$241 thousand and \$1.4 million, respectively for such excess benefits against the provision for income tax expense. Prior to adoption of ASU 2016-09 these tax benefits were recorded directly to additional paid-in capital. Tax benefits recorded to capital for the three and nine months ended September 30, 2016 were \$443 thousand and \$963 thousand, respectively.

**Commitments**

Bancorp uses a variety of financial instruments in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. A discussion of Bancorp’s commitments is included in Note 15.

Other commitments discussed in Bancorp's Annual Report on Form 10-K for the year ended December 31, 2016, have not materially changed since that report was filed, relative to qualitative and quantitative disclosures of fixed and determinable contractual obligations.

***b) Financial Condition***

**Balance Sheet**

Total assets increased \$116.4 million, or 3.8%, to \$3.2 billion at September 30, 2017 as compared to \$3.0 billion at December 31, 2016. Loans increased \$29.7 million, or 1.3%, period to period, with increases primarily in commercial and industrial loans, commercial real estate, and to a lesser degree, 1-4 family residential loans. The most significant decrease was seen in commercial construction and development loans, primarily the result of significant loan principal repayments where maturing loans were not replaced with permanent financing. Securities available-for-sale increased by \$1.4 million during the first nine months of 2017. The majority of this increase the result of short-term investments made at quarter end largely offset by maturities during the first nine months of 2017. Included in securities available-for-sale are short-term U.S. government sponsored entities. These securities, which totaled \$150 million at September 30, 2017 and \$100 million at December 31, 2016, normally have a maturity of less than one month, and are purchased at quarter-end as part of a tax minimization strategy. The remaining variance was attributable to reduction in unrealized losses on the securities portfolio to \$431 thousand at September 30, 2017 as compared to unrealized losses of \$1.9 million at December 31, 2016. Funds from maturing available-for-sale investments were held as cash, or invested short term, to fund future loan growth.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

Total liabilities increased \$96.0 million, December 31, 2016 to September 30, 2017, from \$2.7 billion to \$2.8 billion, respectively. Federal funds purchased and other short-term borrowing increased \$114.6 million, period to period, primarily the result of \$150 million in borrowing for the short-term investments mentioned above. Bancorp uses short-term lines of credit to manage its overall liquidity position. Due to normal cyclical activity total deposits decreased \$38.6 million or 1.5%, period to period. Interest bearing demand deposits accounts decreased, \$42.7 million, or 5.6%; time deposits, \$17.8 million, or 7.1%; and non-interest bearing demand deposit accounts, \$3.3 million, or 0.5%. Money market deposit accounts and savings accounts increased, period to period, \$15.7 million, or 2.3%, and \$9.6 million, or 6.8%, respectively. Securities sold under agreements to repurchase increased \$4.3 million, or 6.3%. Other liabilities increased \$16.7 million, or 42.9%.

**Elements of Loan Portfolio**

The following table sets forth the major classifications of the loan portfolio.

(in thousands)

<b>Loans by Type</b>	<b>September 30, 2017</b>	<b>December 31, 2016</b>
Commercial and industrial	\$750,728	\$736,841
Construction and development, excluding undeveloped land	174,310	192,348
Undeveloped land (1)	20,989	21,496
Real estate mortgage:		
Commercial investment	576,810	538,886
Owner occupied commercial	397,804	408,292
1-4 family residential	261,707	249,498
Home equity - first lien	51,925	55,325
Home equity - junior lien	63,416	67,519
Subtotal: real estate mortgage	1,351,662	1,319,520
Consumer	37,431	35,170
<b>Total loans</b>	<b>\$2,335,120</b>	<b>\$2,305,375</b>

- (1) Undeveloped land consists of land acquired for development by the borrower, but for which no development has yet taken place.

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Loan portfolio growth built further on the momentum experienced in the second quarter of 2017, driven by solid loan production that continued to exceed the average pace recorded over the last three years. While all of the Company's markets participated in this growth, Indianapolis, through excellent leadership and a growing lending team, led the way. Still, the conversion of loan production into portfolio growth continued to track below the exceedingly strong rate that characterized 2016 due to several factors, including principal repayments primarily related to commercial construction projects and borrowers who sold collateral or their business. Also, management believes that business owners remain more cautious about the longer-term direction of the economy, awaiting greater clarity on possible tax reform. Considering its loan pipeline, management anticipates continued momentum in net loan growth in the fourth quarter of 2017, although net loan growth could be challenging if loan payoffs persist at high levels.

Bancorp occasionally enters into loan participation agreements with other banks to diversify credit risk. For certain sold participation loans, Bancorp has retained effective control of the loans, typically by restricting the participating institutions from pledging or selling their share of the loan without permission from Bancorp. US GAAP requires the participated portion of these loans to be recorded as secured borrowings. These participated loans are included in the commercial and industrial and real estate mortgage loan totals above, and a corresponding liability is recorded in other liabilities. At September 30, 2017 and December 31, 2016, the total participated portions of loans of this nature were \$18.3 million and \$15.8 million, respectively.

**Allowance for loan losses**

An allowance for loan losses has been established to provide for probable losses on loans that may not be fully repaid. The allowance for loan losses is increased by provisions charged to expense and decreased by charge-offs, net of recoveries, if any. Loans are typically charged off when management deems them uncollectible and after underlying collateral has been liquidated; however, collection efforts continue and future recoveries may occur. Periodically, loans are partially charged off to the net realizable value based upon evaluation of related underlying collateral, including Bancorp's bias for resolution.

The allowance methodology is driven by risk ratings, historical losses, and qualitative factors. The provision for the first nine months of 2017, and the resulting allowance level, reflected a number of factors, including a slight elevation in classified loans and an expansion of the historical look-back period from 24 quarters to 28 quarters. This expansion of the look-back period was applied to all classes and segments of the portfolio. The expansion of the look-back period for the historical loss rates used in the quantitative allocation caused management to review the overall methodology for the qualitative factors to ensure Bancorp was appropriately capturing the risk not addressed in the historical loss rates used in the quantitative allocation. Management believes the extension of the look-back period is

appropriate to ensure capture of the impact of a full economic cycle and more accurately represents the current level of risk inherent in the loan portfolio. Key indicators of loan quality continued to show improvement during 2017, with levels of non-performing loans continuing a five year downward trend. During its review of qualitative factors in the first nine months of 2017, Bancorp noted a potential exposure for one pool of classified loans. Due to this potential exposure, Bancorp increased its qualitative allocation for the allowance for the nine month period.

Additional information regarding Bancorp's methodology for evaluating the adequacy of the allowance for loan loss can be read in the Company's annual 10K.

As of September 30, 2017 the allowance for loan loss was \$24.9 million, a \$900 thousand increase over the December 31, 2016 balance of \$24.0 million. For the comparative periods, the allowance as a percent of average loans was 1.09% and 1.11%, respectively. The allowance as a percent of period end loans, as of each period end, was 1.07% and 1.04%, respectively.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary****Non-performing Loans and Assets**

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

(dollars in thousands)	<b>September 30, 2017</b>	<b>December 31, 2016</b>		
Non-accrual loans (1)	\$ 4,858	\$ 5,295		
Troubled debt restructuring	949	974		
Loans past due 90 days or more and still accruing	261	438		
Non-performing loans	6,068	6,707		
Foreclosed real estate	2,640	5,033		
Non-performing assets	\$ 8,708	\$ 11,740		
Non-performing loans as a percentage of total loans	0.26	%	0.29	%
Non-performing assets as a percentage of total assets	0.28	%	0.39	%

Non-performing assets as of September 30, 2017 were comprised of 33 non-accrual loans, ranging in amount from \$1 to \$907 thousand, five accruing TDRs, and foreclosed real estate held for sale. Foreclosed real estate held at September 30, 2017 included properties of three former lending relationships, with a combined value of \$2.6 million. At September 30, 2017 there were two properties, with a combined recorded investment of \$75 thousand, in the process of foreclosure.

(1) No TDRs previously accruing were moved to non-accrual during the three or nine month periods ending September 30, 2017. No TDRs were non-accrual as of September 30, 2017 or December 31, 2016.

The following table sets forth the major classifications of non-accrual loans:

**Non-accrual loans by type**



Edgar Filing: Stock Yards Bancorp, Inc. - Form 10-Q

(in thousands)	<b>September 30, 2017</b>	<b>December 31, 2016</b>
Commercial and industrial	\$ 1,256	\$ 1,767
Construction and development, excluding undeveloped land	737	538
Undeveloped land	474	474
Real estate mortgage		
Real estate mortgage - commercial investment	55	107
Real estate mortgage - owner occupied commercial	1,470	1,042
Real estate mortgage - 1-4 family residential	785	984
Home equity	81	383
Subtotal: Real estate mortgage	2,391	2,516
Home equity and consumer loans	-	-
Total loans	\$ 4,858	\$ 5,295

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

*c) Liquidity*

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

Bancorp's most liquid assets are comprised of cash and due from banks, available-for-sale marketable investment securities, federal funds sold and interest bearing deposits with banks. Federal funds sold and interest bearing deposits totaled \$81.4 million at September 30, 2017. These investments normally have overnight maturities and are used for general daily liquidity purposes. The fair value of the available-for-sale investment portfolio was \$571.5 million at September 30, 2017. The portfolio includes maturities of approximately \$216.7 million over the next twelve months, including \$150 million of short-term securities which matured in October 2017. Combined with federal funds sold and interest bearing deposits, these offer substantial resources to meet either new loan demand or reductions in Bancorp's deposit funding base. Bancorp pledges portions of its investment securities portfolio to secure public fund deposits, cash balances of certain wealth management and trust accounts, and securities sold under agreements to repurchase. At September 30, 2017, total investment securities pledged for these purposes comprised 58% of the available-for-sale investment portfolio, leaving \$241.8 million of unpledged securities, including \$150 million which matured the first week of October..

Bancorp defines core deposits as demand, savings, and money market deposit accounts and certificates of deposit less than or equal to \$250,000. At September 30, 2017, such deposits totaled \$2.4 billion and represented 99% of Bancorp's total deposits, as compared to \$2.5 billion, or 98% of total deposits at December 31, 2016. Because these deposits are less volatile and are often tied to other products of Bancorp through long lasting relationships they do not put heavy pressure on liquidity. However, many of Bancorp's customers' deposit balances are historically high.

As of September 30, 2017 Bancorp had no brokered deposits. This compares to \$498 thousand, or 0.02% of total deposits, in brokered deposits at December 31, 2016.

Included in the total deposit balances at September 30, 2017 is \$122.4 million of public funds deposits generally comprised of accounts from local government agencies and public school districts in Bancorp's markets.

Other sources of funds available to meet daily needs include FHLB advances. As a member of the FHLB of Cincinnati, Bancorp has access to credit products offered by the FHLB. Bancorp views these borrowings as a low cost alternative to other time deposits. At September 30, 2017, available credit from the FHLB totaled \$367.3 million. Additionally, Bancorp had available federal funds purchased lines with correspondent banks totaling \$105 million at September 30, 2017.

At September 30, 2017 Bancorp had a \$150 million cash management advance from the FHLB. This advance matured in the first week of October, 2017 and was used to manage Bancorp's overall cash position. Due to the short term of the advance, it was recorded on the consolidated balance sheet within Federal funds purchased and other short-term borrowings.

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Bancorp's principal source of cash is dividends paid to it as sole shareholder of the Bank. At September 30, 2017, the Bank may pay up to \$70.3 million in dividends to Bancorp without regulatory approval subject to the ongoing capital requirements of the Bank.

***d) Capital Resources***

At September 30, 2017, stockholders' equity totaled \$334.3 million, an increase of \$20.4 million since December 31, 2016. See the Consolidated Statement of Changes in Stockholders' Equity for further detail of the changes in equity since the end of 2015. One component of equity is accumulated other comprehensive income which, for Bancorp, consists of net unrealized gains or losses on securities available-for-sale and hedging instruments, as well as a minimum pension liability, each net of taxes. Accumulated other comprehensive loss was \$531 thousand at September 30, 2017 compared with a loss of \$1.5 million on December 31, 2016. The \$968 thousand positive difference is primarily a reflection of the effect of the changing interest rate environment during the first nine months of 2017 as short term rates increased slightly, while long term rates decreased, which decreased Bancorp's unrealized loss on securities available for sale.

As of September 30, 2017, Bancorp meets all requirements to be considered well capitalized under regulatory risk-based capital rules, and is not subject to limitations due to the capital conservation buffer. See Footnote 19 to the consolidated financials for more information regarding Bancorp's and the Bank's risk-based capital amounts and ratios as of September 30, 2017 and December 31, 2016.

***e) Non-GAAP Financial Measures***

In addition to capital ratios defined by banking regulators, Bancorp considers various ratios when evaluating capital adequacy and overhead, including tangible common equity to tangible assets, tangible common equity per share, and adjusted efficiency ratio, all of which are non-GAAP measures.

Bancorp believes the tangible common equity ratios are important because of their widespread use by investors as means to evaluate capital adequacy, as they reflect the level of capital available to withstand unexpected market conditions. Because US GAAP does not include capital ratio measures, there are no US GAAP financial measures comparable to these ratios.



Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

The following table reconciles Bancorp's calculation of tangible common equity to amounts reported under US GAAP.

(in thousands, except per share data)	<b>September 30, 2017</b>	<b>December 31, 2016</b>		
Total equity	\$334,255	\$313,872		
Less core deposit intangible	(1,269 )	(1,405 )		
Less goodwill	(682 )	(682 )		
Tangible common equity	\$332,304	\$311,785		
Total assets	\$3,155,913	\$3,039,481		
Less core deposit intangible	(1,269 )	(1,405 )		
Less goodwill	(682 )	(682 )		
Total tangible assets	\$3,153,962	\$3,037,394		
Total shareholders' equity to total assets	10.59	%	10.33	%
Tangible common equity ratio	10.54		10.26	
Number of outstanding shares	22,669	22,617		
Book value per share	\$14.75	\$13.88		
Tangible common equity per share	14.66	13.79		

In addition to the efficiency ratio normally presented, Bancorp considers an adjusted efficiency ratio. Bancorp believes excluding amortization of investments in tax credit partnerships from non-interest expense in this ratio is important because it provides a meaningful comparison to both prior periods, since amortization expense can fluctuate widely between periods depending upon timing of tax credits, and to other companies who do not invest in these partnerships.

Table of Contents**Stock Yards Bancorp, inc. and subsidiary**

The following table reconciles Bancorp's calculation of adjusted efficiency ratios to the ratio reported under US GAAP.

(amounts in thousands)	<b>Three months ended</b>		<b>Nine months ended</b>			
	<b>September 30,</b>		<b>September 30,</b>			
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Non-interest expense	\$21,317	\$20,518	\$63,811	\$60,251		
Net interest income (tax-equivalent)	26,363	24,963	77,179	72,816		
Non-interest income	11,103	11,358	33,575	32,218		
Total revenue	\$37,466	\$36,321	\$110,754	\$105,034		
Efficiency ratio	56.9	% 56.5	% 57.6	% 57.4		
(amounts in thousands)			<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Non-interest expense			\$21,317	\$20,518	\$63,811	\$60,251
Less: amortization of investments in tax credit partnerships			(616 )	(1,015 )	(1,847 )	(3,046 )
Adjusted non-interest expense			20,701	19,503	61,964	57,205
Net interest income (tax-equivalent)			26,363	24,963	77,179	72,816
Non-interest income			11,103	11,358	33,575	32,218
Total revenue			\$37,466	\$36,321	\$110,754	\$105,034
Adjusted efficiency ratio			55.3	% 53.7	% 55.9	% 54.5

***f) Recently Issued Accounting Pronouncements***

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers*, which outlines a single comprehensive model for use in accounting for revenue arising from contracts with customers, and supersedes most current revenue recognition guidance. The ASU was originally effective for fiscal years and interim periods beginning after December 15, 2016. In August 2015, FASB issued ASU 2015-14 which delayed the effective date. The effective date will be annual reporting periods beginning after December 15, 2017, and the interim periods within that year. Bancorp has reviewed existing contractual arrangements and believes the majority of revenue earned is excluded from the scope of the

pronouncement and the impact of adoption if any would be minimal. Bancorp continues to evaluate and develop processes and controls for procedural and disclosure requirements of the standard.

The FASB also issued a series of other ASUs, which update ASU 2014-09. The effective dates for ASU 2014-09 have been updated by ASU 2015-14, *Deferral of the Effective Date*. For public business entities, certain employee benefit plans, and certain not-for-profit entities, ASU 2014-09 is effective for annual and interim periods in fiscal years beginning after December 15, 2017. Earlier application is permitted only as of annual and interim periods in fiscal years beginning after December 15, 2016. Bancorp is including these ASUs in its evaluation and implementation efforts relative to ASU 2014-09.

- ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)
  
- ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing



Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

- ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients
- ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers

In January 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-01, *Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*, which requires equity investments to be measured at fair value with changes in fair value recognized in net income. The ASU is effective for fiscal years and interim periods beginning after December 15, 2017. Because Bancorp does not have significant investments in equity securities, the adoption of ASU 2016-01 is not expected to have a significant impact on Bancorp’s operations or financial statements.

In February 2016, FASB issued ASU No. 2016-02, *Leases*, which requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize on the balance sheet a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for lease term. The new guidance is effective for annual and interim reporting periods beginning after December 15, 2018. The amendment should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. Bancorp has evaluated existing lease commitments and does not expect adoption to significantly impact Bancorp’s financial condition or results of operations.

In June 2016, FASB issued ASU 2016-13, *Measurement of Credit Losses on Financial Instruments*, which significantly changes the way entities recognize impairment of many financial assets by requiring immediate recognition of estimated credit losses expected to occur over their remaining life. This standard will likely have a significant impact on the way Bancorp recognizes credit impairment on loans. Under current US GAAP, credit impairment losses are determined using an incurred-loss model, which recognizes credit losses only when it is probable that all contractual cash flows will not be collected. The initial recognition of loss under CECL differs from current US GAAP because recognition of credit losses will not be based on any triggering event. This should generally result in credit impairment being recognized earlier and immediately after the financial asset is originated or purchased. Bancorp continues to evaluate existing accounting processes, internal controls, and technology capabilities to determine what additional changes will be needed to address the new requirements. These processes and controls require significant judgment, collection and analysis of additional data, and use of estimates. Technology and other resources have been upgraded or modified to capture additional data to support the accounting and disclosure requirements. The new guidance is effective for annual and interim reporting periods beginning after December 15,

2019.

In August 2016, FASB issued ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments*, which amends guidance in ASC 230 on the classification of certain cash receipts and payments in the statement of cash flows. The primary purpose of the ASU is to reduce the diversity in practice that has resulted from the lack of consistent principles on this topic. The ASU's amendments add or clarify guidance on eight cash flow issues. The guidance in the ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. Entities must apply the guidance retrospectively to all periods presented but may apply it prospectively from the earliest date practicable if retrospective application would be impracticable. Bancorp does not anticipate that adoption of the ASU will have a significant impact on the consolidated financial statements of the Company.

66

---

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*, which requires entities to recognize at the transaction date the income tax consequences of inter-company asset transfers other than inventory. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. Entities may early adopt the ASU, but only at the beginning of an annual period for which no financial statements (interim or annual) have already been issued or made available for issuance. Bancorp does not expect adoption of this standard to have a significant impact on the consolidated financial statements of the Company.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which requires companies to include cash and cash equivalents that have restrictions on withdrawal or use in total cash and cash equivalents on the statement of cash flows. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, adjustments should be reflected at the beginning of the fiscal year that includes that interim period. Bancorp does not expect adoption of this standard to have a significant impact on the consolidated financial statements of the Company.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*, which provides a new framework for determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. For all other entities, the ASU is effective for annual periods in fiscal years beginning after December 15, 2018, and interim periods in fiscal years beginning after December 15, 2019. Entities may early adopt the ASU and apply it to transactions that have not been reported in financial statements that have been issued or made available for issuance. Bancorp does not expect adoption of this standard to have a significant impact on the consolidated financial statements of the Company.

In January 2017, the FASB issued ASU 2017-03, *Accounting Changes and Error Corrections (Topic 250) and Investments—Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings (SEC Update)*, which incorporates into the FASB Accounting Standards Codification recent SEC guidance about disclosing, under SEC SAB Topic 11.M, the effect on financial statements of adopting the revenue, leases, and credit losses standards. The SEC staff had previously announced that registrants should include the disclosures starting with their December 2017 financial statements. Bancorp is evaluating the potential impact of implementation of this standard on the consolidated financial statements of the Company.

In January 2017, the FASB issued ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*, which requires an entity to no longer perform a hypothetical purchase price allocation to measure goodwill impairment. Instead, impairment will be measured using the difference between the carrying amount and the fair value of the reporting unit. The changes are effective for public business entities that are SEC filers, for annual and interim periods in fiscal years beginning after December 15, 2019. All entities may early adopt the standard for goodwill impairment tests with measurement dates after January 1, 2017. Bancorp does not expect adoption of this standard to have a significant impact on the consolidated financial statements of the Company.

In February 2017, the FASB issued ASU 2017-05, *Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*, which clarifies the guidance in Subtopic 610-20 on accounting for derecognition of a nonfinancial asset. The ASU also defines in-substance nonfinancial assets and includes guidance on partial sales of nonfinancial assets. An entity is required to apply the amendments in this ASU at the same time that it applies ASU 2014-09. Bancorp does not expect adoption of this standard to have a significant impact on the consolidated financial statements of the Company.

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

In March 2017, the FASB issued ASU 2017-07, *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which requires companies to present the service cost component of net benefit cost in the same line items in which they report compensation cost. Companies will present all other components of net benefit cost outside operating income, if this subtotal is presented. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. Bancorp does not expect adoption of this standard to have a significant impact on the consolidated financial statements of the Company.

In May 2017, the FASB issued ASU 2017-09, *Compensation — Stock Compensation (Topic 718): Scope of Modification Accounting* which clarifies what constitutes a modification of a share-based payment award. This ASU is effective for all entities for annual and interim periods in fiscal years beginning after December 15, 2017. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. Bancorp does not expect adoption of this standard to have a significant impact on the consolidated financial statements of the Company.

In July 2017, the FASB issued ASU 2017-11, *Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), Derivatives and Hedging (Topic 815); I. Accounting for Certain Financial Instruments with Down Round Features. II. Replacement of the Indefinite Deferral for Mandatory Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatory Redeemable Noncontrolling Interests with a Scope Exception*, which makes limited changes to as to classifying certain financial instruments as either liabilities or equity. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. Because Bancorp does not have financial instruments with a down round feature, the implementation of ASU 2017-11 is not expected to have a significant impact on the consolidated financial statements of the Company.

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815); Targeted Improvements for Accounting for Hedging Activities*, which amends the hedge accounting recognition and presentation requirements under ASC 815. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2018. Early adoption of this standard is permitted upon its issuance. Bancorp does not expect adoption of this standard to have a significant impact on the consolidated financial statements of the Company.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

68

---

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Bancorp maintains disclosure controls and procedures designed to ensure that it is able to collect the information it is required to disclose in the reports it files with the Securities and Exchange Commission (SEC), and to record, process, summarize and disclose this information within the time periods specified in the rules of the SEC.

Based on their evaluation of Bancorp's disclosure controls and procedures, the Chief Executive and Chief Financial Officers have concluded that, because of the material weakness described in Management's Report on Internal Control Over Financial Reporting in our Annual Report on Form 10-K for the year ended December 31, 2016, Bancorp's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were not effective as of September 30, 2017. However, based on a number of factors, we believe that the consolidated financial statements in this Quarterly Report on Form 10-Q fairly present, in all material respects, our financial position and results of operation and cash flows for the periods presented in conformity with US GAAP.

Changes in Internal Control over Financial Reporting

With regard to the material weakness, our remediation efforts began during the first quarter of 2017. We continue to strengthen how certain controls are designed, performed and documented. We have increased staffing in the internal loan review department, and engaged a third party to assist with loan review. We must now demonstrate the effectiveness of these changes with an appropriate amount of consistency and for a sufficient period of time to conclude that the control is functioning properly. Other than these changes, based on the evaluation of Bancorp's disclosure controls and procedures by the Chief Executive and Chief Financial Officers, there were no significant changes during the quarter ended September 30, 2017 in Bancorp's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, Bancorp's internal control over financial reporting.

PART II – OTHER INFORMATION

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

The following table shows information relating to the repurchase of shares of common stock by Bancorp during the three months ended September 30, 2017.

	<b>Total number of shares purchased (1)</b>	<b>Average price paid per share</b>	<b>Total number of shares purchased as part of publicly announced plan</b>	<b>Maximum number of shares that may yet be purchased under the plan</b>
July 1 - July 31	-	\$ -	-	-
August 1 - August 31	2,280	\$ 35.62	-	-
Sep 1 - Sep 30	2,306	\$ 37.52	-	-
Total	4,586	\$ 36.58	-	-

(1) Activity represents shares of stock withheld to pay taxes due upon exercise of stock appreciation rights.



Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

Item 6. Exhibits

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

**Exhibit**

**Description of exhibit**

**Number**

31.1 Certifications pursuant to Section 302 of the Sarbanes-Oxley Act by David P. Heintzman

31.2 Certifications pursuant to Section 302 of the Sarbanes-Oxley Act by Nancy B. Davis

32 Certifications pursuant to 18 U.S.C. Section 1350

101 The following financial statements from the Stock Yards Bancorp, Inc. September 30, 2017 Quarterly Report on Form 10-Q, filed on November 3, 2017, formatted in eXtensible Business Reporting Language (XBRL):

- (1) Consolidated Balance Sheets
- (2) Consolidated Statements of Income
- (3) Consolidated Statements of Comprehensive Income
- (4) Consolidated Statements of Changes in Stockholders' Equity
- (5) Consolidated Statements of Cash Flows
- (6) Notes to Consolidated Financial Statements

Table of Contents

**Stock Yards Bancorp, inc. and subsidiary**

**Signatures**

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

**STOCK YARDS BANCORP, INC.**

By: /s/ David P. Heintzman

Date: November 3, 2017 David P. Heintzman, Chairman

and Chief Executive Officer

By: /s/ Nancy B. Davis

Date: November 3, 2017 Nancy B. Davis, Executive Vice President,

Treasurer and Chief Financial Officer