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

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K

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

For the Fiscal Year Ended December 31, 2007

Commission File Number 1-13661

S.Y. BANCORP, INC.

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

Incorporated in Kentucky	**I.R.S. No. 61-1137529**

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

Title of each class:	**Name of each exchange on which registered:**
Common Stock, no par value	**NASDAQ**
Preferred Share Purchase Rights	**NASDAQ**

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

None

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

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

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

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

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

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

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

Yes o No x

The aggregate market value of registrant s voting stock (Common Stock, no par value) held by non-affiliates of the registrant as of June 30, 2007 (the last business day of the registrant s most recently completed second fiscal quarter) was $300,613,000.

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

Documents Incorporated By Reference

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

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Part I

Item 1. Business

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

Stock Yards Bank & Trust Company

Stock Yards Bank & Trust Company is the only banking subsidiary of Bancorp and was originally chartered in 1904. The Bank is headquartered in Louisville, Kentucky and provides commercial banking services in the Louisville Metropolitan Statistical Area (MSA), Indianapolis and Cincinnati through 28 full service banking offices (See ITEM 2. PROPERTIES). The Bank is chartered under the laws of the Commonwealth of Kentucky. In addition to traditional commercial and personal banking activities, the Bank has an investment management and trust department offering a wide range of trust and investment services. This department operates under the name of Stock Yards Trust Company. The Bank also originates and sells single-family residential mortgages through Stock Yards Mortgage Company. Additionally, the Bank offers securities brokerage services and life insurance products through arrangements with a third party provider. See Note 21 to Bancorp s consolidated financial statements for the year ended December 31, 2007 for information relating to the Bank s business segments.

At December 31, 2007, the Bank had 446 full-time equivalent employees. Management of Bancorp strives to be an employer of choice and considers the relationship with employees to be good.

Supervision and Regulation

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

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

The Bank is subject to the supervision of and regular examination by the Federal Deposit Insurance Corporation and the Kentucky Department of Financial Institutions. The Federal Deposit Insurance Corporation insures the deposits of the Bank to the current maximums of $100,000 per depositor for time and demand deposit accounts, and $250,000 per depositor for self-directed retirement accounts.

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

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

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

Available Information

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

Item 1A. Risk Factors

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

Fluctuations in interest rates could reduce Bancorp s profitability.

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

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

- inflation;
- recession;
- a rise in unemployment;
- tightening money supply; and
- international disorder and instability in domestic and foreign financial markets.

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

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

Bancorp faces vigorous competition from banks and other financial institutions. A number of these banks and other financial institutions have substantially greater resources and lending limits, larger branch systems and a wider array of banking services. Additionally, Bancorp encounters competition from both de novo and smaller community banks entering its markets. Bancorp also competes with other providers of financial services, such as brokerage firms, consumer finance companies and insurance companies. This competition may reduce or limit Bancorp s margins on banking services, reduce Bancorp s market share and adversely affect Bancorp s results of operations and financial condition.

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

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

Bancorp s profitability depends on local and national economic conditions.

Bancorp s success depends on general economic conditions both locally and nationally. Most of Bancorp s customers are in the Louisville MSA with a growing number of customers in the Indianapolis and Cincinnati areas. Some of Bancorp s customers are directly impacted by the local economy while others have more national or global business dealings. Some of the factors influencing general economic conditions include inflation, recession, and unemployment. Economic conditions can have an impact on the demand of Bancorp s customers for loans, the ability of some borrowers to repay these loans, and the value of the collateral securing these loans.

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

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

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

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

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

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

Item 1B. Unresolved Staff Comments

Bancorp has no unresolved SEC staff comments.

Item 2. Properties

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

Item 3. Legal Proceedings

See Note 17 to Bancorp s consolidated financial statements for the year ended December 31, 2007, for information relating to legal proceedings.

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

None

Executive Officers of the Registrant

The following table lists the names and ages (as of December 31, 2007) of all current executive officers of Bancorp. Each executive officer is appointed by Bancorp s Board of Directors to serve at the discretion of the Board. There is no arrangement or understanding between any executive officer of Bancorp and any other person(s) pursuant to which he/she was or is to be selected as an officer.

Name and Age of Executive Officer	Position and Offices with Bank
David P. Heintzman Age 48	Chairman, President and Chief Executive Officer
Kathy C. Thompson Age 46	Senior Executive Vice President and Director
Nancy B. Davis Age 52	Executive Vice President, Secretary, Treasurer and Chief Financial Officer

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

Ms. Thompson was appointed Senior Executive Vice President in January 2005. Prior thereto, she served as Executive Vice President of Bancorp and the Bank. She joined the Bank in 1992 and is Manager of the Investment Management and Trust Department and is also responsible for the sales, service and marketing areas of the Bank.

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

Part II

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

Bancorp s common stock is traded on the NASDAQ Global Select under the ticker symbol SYBT. Prior to July 2005, the stock traded on the American Stock Exchange under the symbol SYI. The table below sets forth the quarterly high and low market closing prices of Bancorp s common stock and dividends declared per share. The payment of dividends by the Bank to Bancorp is subject to the restriction described in Note 16 to the consolidated financial statements. Management believes that Bancorp will continue to generate adequate earnings to continue to pay dividends on a quarterly basis. On December 31, 2007, Bancorp had 1,285 shareholders of record, and approximately 2,700 non-objecting beneficial owners holding shares in nominee or street name.

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

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

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares that May Yet Be Purchased Under the Plan
October 1-October 31	171,500	$ 26.43	171,500	80,524
November 1-November 30	130,624	23.29	130,624	499,900
December 1-December 31	109,300	23.63	109,300	390,600
Total	411,424	$ 24.69	411,424	390,600

The Board of Directors of S.Y. Bancorp Inc. first approved a share buyback plan in 1999. In February 2005, the Directors of Bancorp expanded this plan to allow for the repurchase of up to 577,500 shares. In July 2007, the Directors expanded this plan by 550,000 shares. In November 2007, the Directors expanded this plan again by 550,000 additional shares. That plan s expiration date is set for November 2008. In November 2007, as part of this stock repurchase program, the Company established a Rule 10b5-1 stock trading plan. As of December 31, 2007, 390,600 shares remain to be purchased under the program.

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

The graph compares the performance of Bancorp Common Stock to the Russell 2000 index, the SNL NASDAQ Bank index and the SNL Midwest Bank index for Bancorp s last five fiscal years. The graph assumes the value of the investment in Bancorp Common Stock and in each index was $100 at December 31, 2002 and that all dividends were reinvested.

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

Item 6. Selected Financial Data

Selected Consolidated Financial Data

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

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

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

The purpose of this discussion is to provide information as to the analysis of the consolidated financial condition and results of operations of S.Y. Bancorp, Inc. (Bancorp) and its wholly owned subsidiary, Stock Yards Bank & Trust Company (the Bank). Bancorp, incorporated in 1988, has no active business operations. Thus, Bancorp s business is substantially the same as that of the Bank. The Bank has operated continuously since it opened in 1904. The Bank conducted business at one location for 85 years and then began branching. At December 31, 2007, the Bank had twenty-five full service banking locations in the Louisville Metropolitan Statistical Area (MSA), two full service banking locations in Indianapolis, Indiana and a loan production office in Cincinnati, Ohio. In January 2008, the Cincinnati office moved into a permanent facility and converted to a full-service branch. The Bank s focus on flexible, attentive customer service has been key to the Bank s growth and profitability. The wide range of services added by the investment management and trust department, the brokerage department, and the mortgage department helps support the corporate philosophy of capitalizing on full service customer relationships.

Forward-Looking Statements

This report contains forward-looking statements under the Private Securities Litigation Reform Act that involve risks and uncertainties. These forward-looking statements may be identified by the use of words such as expect , anticipate , plan , foresee or other words with similar meaning. Although Bancorp believes the assumptions underlying the forward-looking statements contained herein are reasonable, any of these assumptions could be inaccurate. Factors that could cause actual results to differ from results discussed in forward-looking statements include, but are not limited to: economic conditions both generally and more specifically in the markets in which Bancorp and its subsidiaries operate; competition for the Bank s customers from other providers of financial services; government legislation and regulation which change from time to time and over which Bancorp has no control; changes in interest rates; material unforeseen changes in liquidity, results of operations or financial condition of the Bank s customers; or other risks detailed in Bancorp s filings with the Securities and Exchange Commission and Item 1A of this Form 10-K all of which are difficult to predict and many of which are beyond the control of Bancorp.

Critical Accounting Policies

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

Management has identified the accounting policy related to the allowance and provision for loan losses as critical to the understanding of Bancorp s results of operations and discussed this conclusion with the Audit Committee of the Board of Directors. Since the application of this policy requires significant management assumptions and estimates, it could result in materially different amounts to be reported if conditions or underlying circumstances were to change. Assumptions include many factors such as changes in borrowers financial condition which can change quickly or historical loss ratios related to certain loan portfolios which may or may not be indicative of future losses. To the extent that management s assumptions prove incorrect, the results from operations could be materially affected by a higher provision for loan losses. The impact and any associated risks related to this policy on Bancorp s business operations are discussed in the Allowance for Loan Losses section below.

Additionally, management has identified the accounting policy related to accounting for income taxes as critical to the understanding of Bancorp s results of operations and discussed this conclusion with the Audit Committee of the Board of Directors. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity s financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in Bancorp s financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences, including the effects of IRS examinations and examinations by other state agencies, could materially impact Bancorp s financial position and its results from operations. Additional information regarding income taxes is discussed in the Income Taxes section below and note 7 to the consolidated financial statements.

Overview of 2007

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

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

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

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

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

Also impacting 2007 net income, Bancorp:

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

- Accelerated its expansion activities with the addition of a second office in Indianapolis in late 2007 and hiring officers to open an office in Cincinnati in January 2008.

- Reduced its tax expense in 2007 for a correction to deferred tax liabilities of approximately $648,000 and adjusted other tax-related balances to reflect finalization of its most recently filed tax returns, which related to prior years.

- Experienced net interest margin erosion as the Federal Reserve Board lowered rates in the second half of 2007 and loans indexed to the prime rate repriced immediately down with the rate changes.

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

- The Federal Reserve Board continued to lower rates into 2008. Approximately 40% of the Bank s loans are indexed to the prime interest rate and reprice immediately with Federal Reserve rate changes. Deposit rates generally do not reprice as quickly.

- Competition from other financial institutions both well established and newcomers results in loan and deposit pricing pressures.

- To achieve our goals for 2008, net loan growth must exceed that of 2007. This will be impacted by competition and prevailing economic conditions. While we believe there is significant opportunity for growth in the Louisville MSA, we know that our ability to deliver attractive growth over the long-term is linked to our success in new markets, including Indianapolis and Cincinnati.

- While the Bank has responded aggressively to work through loan problems as exhibited by year-end credit quality metrics, we are not immune from challenges that affect the economy as a whole. We will continue to monitor it closely, but credit quality could be a challenge in the coming year.

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

Results of Operations

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

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

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

Net Interest Income

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

Comparative information regarding net interest income follows:

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

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

Prime rate and the five year treasury are included above to provide a general indication of the interest rate environment in which the Bank operated. Approximately 40% of the Bank s loans are variable rate and most of these loans are indexed to the Bank s prime rate and reprice as the prime rate changes. Most of the Bank s fixed rate loans are priced in relation to the five year Treasury bond.

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

For 2008 management anticipates a declining prime rate and competitive pressures could further decrease the rate the Bank earns on loans. Similarly, contractual repricing coupled with ever increasing competition could increase the rates paid on deposit accounts. These factors would result in compression of net interest spread and margin.

Asset/Liability Management and Interest Rate Risk

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

Interest Rate Simulation Sensitivity Analysis

Bancorp uses an earnings simulation model to estimate and evaluate the impact of changing interest rates on earnings. The simulation model is designed to reflect the dynamics of interest earning assets, interest bearing liabilities and off-balance sheet financial instruments in a one year forecast. By estimating the effects of interest rate increases and decreases, the model can reveal approximate interest rate risk exposure. The simulation model is used by management to gauge approximate results given a specific change in interest rates at a given point in time. The model is therefore a tool to indicate earnings trends in given interest rate scenarios and does not indicate actual expected results. The December 31, 2007 simulation analysis indicates that an increase in interest rates of 100 to 200 basis points would have a positive effect on net interest income, and a decrease of 100 to 200 basis points in interest rates would have a negative effect on net interest income. These estimates are summarized below.

	Net Interest Income % Change
Increase 200 bp	0.56
Increase 100 bp	0.28
Decrease 100 bp	(0.24)
Decrease 200 bp	(0.50)

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

The following table presents the increases in net interest income due to changes in rate and volume computed on a tax-equivalent basis and indicates how net interest income in 2007 and 2006 was impacted by volume increases and the higher average interest rate environment. The tax-equivalent adjustments are based on a 35% federal tax rate. The change in interest due to both rate and volume has been allocated to the change due to rate and the change due to volume in proportion to the relationship of the absolute dollar amounts of the change in each.

Taxable Equivalent Rate/Volume Analysis

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

Bancorp s net interest income decreased $58,000 for the year ended December 31, 2007 compared to the same period of 2006 while 2006 compared to 2005 saw a $4,781,000 increase. Net interest income for the year 2007 compared to 2006 was positively impacted by an increase in loan volume and a slight increase in the average rate earned on assets and negatively impacted by an increase in deposit and other borrowing rates. Loan growth accounted for $4,772,000 of the increase in interest income, which was somewhat offset by increased interest expense of $2,718,000 due to higher rates on money market and time deposits and $1,454,000 due to higher money market and time deposit volume. Growth in FHLB borrowings accounted for $1,462,000 of the increase in interest expense and an increase in average FHLB rates also increased interest expense by $272,000.

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

Provision for Loan Losses

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

(Dollars in thousands)	2007	2006	2005
Provision for loan losses	$ 3,525	$ 2,100	$ 225
Allowance to loans at year end	1.12%	1.06%	1.14%
Allowance to average loans for year	1.16%	1.12%	1.19%

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

The Bank s loan portfolio is diversified with no significant concentrations of credit. Geographically, most loans are extended to borrowers in the Louisville, Kentucky and Indianapolis, Indiana metropolitan areas. The adequacy of the allowance is monitored on an ongoing basis and it is the opinion of management that the balance of the allowance for loan losses at December 31, 2007 is adequate to absorb losses inherent in the loan portfolio as of the financial statement date. See Financial Condition-Allowance for Loan Losses for more information on the allowance for loan losses.

Non-Interest Income and Non-Interest Expenses

The following table provides a comparison of the components of non-interest income for 2007, 2006 and 2005. The table shows the dollar and percentage change from 2006 to 2007 and from 2005 to 2006. Below the table is a discussion of significant changes and trends.

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

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

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

December 31, 2007 assets under management totaled $1.7 billion compared to $1.6 billion at December 31, 2006 and $1.4 billion as of December 31, 2005. Because assets under management are expressed in terms of fair value, increases in market value of existing accounts during the last three years and the attraction of new business have both served to increase assets under management. Growth in the department s assets consisted primarily of personal trust accounts during both 2007 and 2006. Some revenues of the investment management and trust department, most notably executor fees, are non-recurring in nature and the timing of these revenues corresponds with the administration of estates. For 2007, 2006 and 2005 executor fees totaled approximately $1,024,000, $763,000 and $730,000, respectively.

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

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

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

Brokerage commissions and fees earned primarily from stock, bond and mutual fund sales decreased slightly during 2007 as overall transaction volume was down compared to the prior year. Turnover in brokerage positions throughout 2007 also negatively impacted income. Bancorp continues to offer a full compliment of financial services to its customer base and feels that brokerage services are a key component of that strategy.

Income related to bank-owned life insurance (BOLI) increased during 2007. BOLI generated income of $985,000 and $914,000 during 2007 and 2006, respectively. This income helps offset the rising cost of employee benefits.

Other non-interest income increased slightly during 2007 compared to 2006 partly as a result of an increase in fees derived from business internet banking services. Other non-interest income decreased slightly from 2006 compared to 2005 due to a variety of factors none of which are individually significant.

The following table provides a comparison of the components of non-interest expenses for 2007, 2006 and 2005. The table shows the dollar and percentage change from 2006 to 2007 and from 2005 to 2006. Below the table is a discussion of significant changes and trends.

				2007/2006		2006/2005	
(Dollars in thousands)	**2007**	**2006**	**2005**	**Change**	**%**	**Change**	**%**
Non-interest expense							