Stock Yards Bancorp, Inc.
Form 10-Q
November 05, 2015
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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, 2015

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 incorporation or organization)	(I.R.S. Employer 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 or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

Yes No __

The number of shares of the registrant's Common Stock, no par value, outstanding as of October 27, 2015, was 14,870,711.

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STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Consolidated Balance Sheets

September 30, 2015 and December 31, 2014

(In thousands, except share data)

Assets	**September 30, 2015 (Unaudited)**	**December 31, 2014**
Cash and due from banks	$ 37,335	$ 42,216
Federal funds sold	17,859	32,025
Cash and cash equivalents	55,194	74,241
Mortgage loans held for sale	5,539	3,747
Securities available-for-sale (amortized cost of $498,633 and $509,276 in 2015 and 2014, respectively)	504,366	513,056
Federal Home Loan Bank stock and other securities	6,347	6,347
Loans	1,954,425	1,868,550
Less allowance for loan losses	21,614	24,920
Net loans	1,932,811	1,843,630
Premises and equipment, net	39,951	39,088
Bank owned life insurance	30,777	30,107
Accrued interest receivable	6,058	5,980
Other assets	43,564	47,672
Total assets	$ 2,624,607	$ 2,563,868
Liabilities and Stockholders’ Equity		
Deposits:		
Non-interest bearing	$ 595,039	$ 523,947
Interest bearing	1,546,539	1,599,680
Total deposits	2,141,578	2,123,627
Securities sold under agreements to repurchase	67,557	69,559
Federal funds purchased	62,101	47,390
Accrued interest payable	126	131
Other liabilities	28,598	26,434
Federal Home Loan Bank advances	43,699	36,832
Total liabilities	2,343,659	2,303,973
Stockholders’ equity:		
Preferred stock, no par value. Authorized 1,000,000 shares; no shares issued or outstanding	—	—
Common stock, no par value. Authorized 20,000,000 shares; issued and outstanding 14,868,894 and 14,744,684 shares in 2015 and 2014, respectively	10,448	10,035
Additional paid-in capital	42,217	38,191

Retained earnings	225,178	209,584
Accumulated other comprehensive income	3,105	2,085
Total stockholders’ equity	280,948	259,895
Total liabilities and stockholders’ equity	$ 2,624,607	$ 2,563,868

See accompanying notes to unaudited consolidated financial statements.

STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Income (Unaudited)

For the three and nine months ended September 30, 2015 and 2014

(In thousands, except per share data)

	For three months ended September 30,		**For nine months ended September 30,**	
	2015	**2014**	**2015**	**2014**
Interest income:				
Loans	$20,924	$20,429	$61,951	$59,575
Federal funds sold	65	73	184	215
Mortgage loans held for sale	67	54	180	128
Securities – taxable	1,936	1,845	5,939	5,506
Securities – tax-exempt	292	291	877	885
Total interest income	23,284	22,692	69,131	66,309
Interest expense:				
Deposits	900	1,065	2,811	3,319
Federal funds purchased	7	8	19	23
Securities sold under agreements to repurchase	42	37	111	100
Federal Home Loan Bank advances	254	219	694	621
Total interest expense	1,203	1,329	3,635	4,063
Net interest income	22,081	21,363	65,496	62,246
Provision (credit) for loan losses	—	(2,100)	—	(400)
Net interest income after provision for loan losses	22,081	23,463	65,496	62,646
Non-interest income:				
Investment management and trust services	4,373	4,502	13,576	13,825
Service charges on deposit accounts	2,342	2,294	6,621	6,620
Bankcard transaction revenue	1,223	1,182	3,591	3,466
Mortgage banking revenue	772	641	2,513	1,951
Gain (loss) on sales of securities available for sale	—	—	—	(9)
Brokerage commissions and fees	585	539	1,545	1,506
Bank owned life insurance income	222	229	670	699
Other	468	463	1,361	1,324
Total non-interest income	9,985	9,850	29,877	29,382
Non-interest expenses:				
Salaries and employee benefits	11,333	11,855	33,816	33,697
Net occupancy expense	1,518	1,422	4,437	4,431
Data processing expense	1,572	1,591	4,782	4,869
Furniture and equipment expense	282	269	789	796
FDIC insurance expense	318	340	932	1,032
Loss (gain) on other real estate owned	(12)	7	153	(342)

Other	3,419	3,225	10,167	9,471
Total non-interest expenses	18,430	18,709	55,076	53,954
Income before income taxes	13,636	14,604	40,297	38,074
Income tax expense	4,352	4,715	12,756	11,974
Net income	$9,284	$9,889	$27,541	$26,100
Net income per share:				
Basic	$0.63	$0.68	$1.87	$1.79
Diluted	$0.62	$0.67	$1.84	$1.77
Average common shares:				
Basic	14,754	14,574	14,704	14,542
Diluted	14,986	14,748	14,940	14,732

See accompanying notes to unaudited consolidated financial statements.

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STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Comprehensive Income (Unaudited)

For the three and nine months ended September 30, 2015 and 2014

(In thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2015	**2014**	**2015**	**2014**
Net income	$9,284	$9,889	$27,541	$26,100
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on securities available for sale:				
Unrealized gains (losses) arising during the period (net of tax of $1,089, ($234), $683 and $1,521, respectively)	2,023	(435)	1,270	2,823
Reclassification adjustment for securities losses realized in income (net of tax of $0, $0, $0, and $3, respectively)	—	—	—	6
Unrealized (losses) gains on hedging instruments:				
Unrealized (losses) gains arising during the period (net of tax of ($124), $12, ($135) and $6, respectively)	(231)	23	(250)	10
Other comprehensive income (loss), net of tax	1,792	(412)	1,020	2,839
Comprehensive income	$11,076	$9,477	$28,561	$28,939

See accompanying notes to unaudited consolidated financial statements.

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STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

For the nine months ended September 30, 2015 and 2014

(In thousands, except per share data)

	Common stock Number of shares	**Amount**	**Additional paid-in capital**	**Retained earnings**	**Accumulated other comprehensive income (loss)**	**Total**
Balance December 31, 2013	14,609	$9,581	$ 33,255	$188,825	$ (2,217)	$229,444
Net income	—	—	—	26,100	—	26,100
Other comprehensive income, net of tax	—	—	—	—	2,839	2,839
Stock compensation expense	—	—	1,459	—	—	1,459
Stock issued for exercise of stock options, net of withholdings to satisfy employee tax obligations upon vesting of stock awards	81	269	1,870	(95)	—	2,044
Stock issued for non-vested restricted stock	40	132	1,022	(1,154)	—	—
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	5	18	(111)		—	(93)
Cash dividends declared, $0.65 per share	—	—	—	(9,534)	—	(9,534)
Shares repurchased or cancelled	(31)	(102)	(784)	73	—	(813)
Balance September 30, 2014	14,704	$9,898	$ 36,711	$204,215	$ 622	$251,446
Balance December 31, 2014	14,745	$10,035	$ 38,191	$209,584	$ 2,085	$259,895
Net income	—	—	—	27,541	—	27,541
Other comprehensive income, net of tax	—	—	—	—	1,020	1,020

Stock compensation expense	—	—	1,561	—	—	1,561
Stock issued for exercise of stock options, net of withholdings to satisfy employee tax obligations upon vesting of stock awards	92	307	2,383	(201)	—	2,489
Stock issued for non-vested restricted stock	35	116	1,088	(1,204)	—	—
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	18	60	(397)	(128)	—	(465)
Cash dividends declared, $0.71 per share	—	—	—	(10,519)	—	(10,519)
Shares repurchased or cancelled	(21)	(70)	(609)	105	—	(574)
Balance September 30, 2015	14,869	$ 10,448	$ 42,217	$ 225,178	$ 3,105	$ 280,948

See accompanying notes to unaudited consolidated financial statements.

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STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows (Unaudited)

For the nine months ended September 30, 2015 and 2014

(In thousands)

	2015	**2014**
Operating activities:		
Net income	$27,541	$26,100
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (credit) for loan losses	—	(400)
Depreciation, amortization and accretion, net	5,088	3,226
Deferred income tax expense (benefit)	1,326	(252)
Loss on sale of securities available for sale	—	9
Gain on sales of mortgage loans held for sale	(1,611)	(769)
Origination of mortgage loans held for sale	(90,997)	(64,332)
Proceeds from sale of mortgage loans held for sale	90,816	63,159
Bank owned life insurance income	(670)	(699)
Loss (gain) on the disposal of premises and equipment	3	(30)
Loss (gain) on the sale of other real estate	153	(342)
Stock compensation expense	1,561	1,459
Excess tax benefits from share-based compensation arrangements	(366)	(257)
(Increase) decrease in accrued interest receivable and other assets	(1,049)	1,107
Increase in accrued interest payable and other liabilities	2,509	2,049
Net cash provided by operating activities	34,304	30,028
Investing activities:		
Purchases of securities available for sale	(203,465)	(220,296)
Proceeds from sale of securities available for sale	5,934	7,732
Proceeds from maturities of securities available for sale	206,734	256,948
Net increase in loans	(90,224)	(66,748)
Purchases of premises and equipment	(3,136)	(1,517)
Proceeds from disposal of premises and equipment	—	344
Proceeds from sale of foreclosed assets	2,332	4,768
Net cash used in investing activities	(81,825)	(18,769)
Financing activities:		
Net increase in deposits	17,951	26,884
Net increase (decrease) in securities sold under agreements to repurchase and federal funds purchased	12,709	(34,659)
Proceeds from Federal Home Loan Bank advances	78,200	32,740
Repayments of Federal Home Loan Bank advances	(71,333)	(30,150)
Issuance of common stock for options and performance stock units	1,994	1,445
Excess tax benefits from share-based compensation arrangements	366	257
Common stock repurchases	(910)	(564)

Cash dividends paid	(10,503)	(9,534)
Net cash provided by (used in) financing activities	28,474	(13,581)
Net decrease in cash and cash equivalents	(19,047)	(2,322)
Cash and cash equivalents at beginning of period	74,241	70,770
Cash and cash equivalents at end of period	$55,194	$68,448
Supplemental cash flow information:		
Income tax payments	$10,177	$8,764
Cash paid for interest	3,640	4,063
Supplemental non-cash activity:		
Transfers from loans to other real estate owned	$1,043	$1,780

See accompanying notes to unaudited consolidated financial statements.

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Notes to Consolidated Financial Statements (Unaudited)

(1) Summary of Significant Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared in accordance with the 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 intercompany 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 the reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of related revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, 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, 2014 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, 2015 are not necessarily indicative of the results for the entire year.

Critical Accounting Policies

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. In the second quarter of 2015, Bancorp extended the historical period used to capture Bancorp's historical loss ratios from 12 quarters to 24 quarters. 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, the 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 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 the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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Bancorp's allowance calculation includes allocations to loan portfolio segments at September 30, 2015 for qualitative factors including, among other factors, local economic and business conditions, the quality and experience of lending staff and management, changes in lending policies and procedures, levels of and trends in past due loans and loan classifications, concentrations of credit such as collateral type, trends in portfolio growth, changes in the value of underlying collateral for collateral-dependent loans considering Bancorp's disposition bias, effect of other external factors such as the national economic and business trends, and the quality and depth of the loan review function. Bancorp may also consider other qualitative factors in future periods for additional allowance allocations, including, among other factors, changes in Bancorp's loan review process. 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 the criteria used in this evaluation or the 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 and lease 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)	**Amortized**	**Unrealized**		**Fair**
September 30, 2015	**cost**	**Gains**	**Losses**	**value**
U.S. Treasury and other U.S. Government obligations	$ 100,000	$-	$-	$100,000
Government sponsored enterprise obligations	184,258	2,746	194	186,810
Mortgage-backed securities - government agencies	152,552	2,564	769	154,347
Obligations of states and political subdivisions	61,067	1,482	41	62,508
Corporate equity securities	756	-	55	701
Total securities available for sale	$ 498,633	$6,792	$1,059	$504,366
December 31, 2014				
U.S. Treasury and other U.S. Government obligations	$ 70,000	$-	$-	$70,000
Government sponsored enterprise obligations	203,531	2,017	562	204,986
Mortgage-backed securities - government agencies	173,573	2,042	1,345	174,270
Obligations of states and political subdivisions	61,416	1,560	142	62,834
Corporate equity securities	756	210	-	966
Total securities available for sale	$ 509,276	$5,829	$2,049	$513,056

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, 2015 or December 31, 2014.

In the first quarter of 2015, Bancorp sold securities with total fair market value of $5.9 million, generating no gain or loss. These securities consisted of agency and mortgage-backed securities with small remaining balances and agency securities. In 2014, Bancorp sold securities with total fair market value of $7.7 million, generating a net loss of $9 thousand. These securities consisted of mortgage-backed securities with small remaining balances, obligations of state and political subdivisions, and agency securities. These sales were made in the ordinary course of portfolio management. Management has the intent and ability to hold all remaining investment securities available-for-sale for the foreseeable future.

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A summary of the available-for-sale investment securities by contractual maturity groupings as of September 30, 2015 is shown below.

(in thousands)

Securities available-for-sale	**Amortized cost**	**Fair value**
Due within 1 year	$125,176	$125,348
Due after 1 but within 5 years	114,928	117,100
Due after 5 but within 10 years	15,694	15,992
Due after 10 years	89,527	90,878
Mortgage-backed securities	152,552	154,347
Corporate equity securities	756	701
Total securities available-for-sale	$498,633	$504,366

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 the underlying collateral.

Securities with a carrying value of approximately $278.1 million at September 30, 2015 and $263.1 million at December 31, 2014 were pledged to secure accounts of commercial depositors in cash management accounts, public deposits, and cash balances for certain investment management and trust accounts.

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Securities with unrealized losses at September 30, 2015 and December 31, 2014, not recognized in the statements of income are as follows:

(in thousands)	Less than 12 months		12 months or more		Total	
September 30, 2015	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**
Government sponsored enterprise obligations	$6,353	$ 8	$8,740	$ 186	$15,093	$ 194
Mortgage-backed securities - government agencies	12,929	129	31,734	640	44,663	769
Obligations of states and political subdivisions	7,817	25	2,232	16	10,049	41
Corporate equity securities	701	55	-	-	701	55
Total temporarily impaired securities	$27,800	$ 217	$42,706	$ 842	$70,506	$ 1,059
December 31, 2014						
Government sponsored enterprise obligations	$36,979	$ 30	$26,848	$ 532	$63,827	$ 562
Mortgage-backed securities - government agencies	4,038	77	49,325	1,268	53,363	1,345
Obligations of states and political subdivisions	12,655	67	6,297	75	18,952	142
Total temporarily impaired securities	$53,672	$ 174	$82,470	$ 1,875	$136,142	$ 2,049

Applicable dates for determining when securities are in an unrealized loss position are September 30, 2015 and December 31, 2014. 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. These investments consist of 45 and 80 separate investment positions as of September 30, 2015 and December 31, 2014, respectively. 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, 2015.

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

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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)	**September 30, 2015**	**December 31, 2014**
Commercial and industrial	$610,877	$571,754
Construction and development, excluding undeveloped land	109,870	95,733
Undeveloped land	18,950	21,268
Real estate mortgage:		
Commercial investment	491,171	487,822
Owner occupied commercial	357,628	340,982
1-4 family residential	222,643	211,548
Home equity - first lien	49,937	43,779
Home equity - junior lien	62,223	66,268
Subtotal: Real estate mortgage	1,183,602	1,150,399
Consumer	31,126	29,396
Total loans	$1,954,425	$1,868,550

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Stock Yards Bancorp, inc. and subsidiary

The following table presents the balance in the recorded investment in loans and allowance for loan losses by portfolio segment and based on impairment evaluation method as of September 30, 2015 and December 31, 2014.

(in thousands)	Type of loan					
September 30, 2015	**Commercial and industrial**	**Construction and development excluding undeveloped land**	**Undeveloped land**	**Real estate mortgage**	**Consumer**	**Total**
Loans	$610,877	$ 109,870	$ 18,950	$1,183,602	$ 31,126	$1,954,425
Loans collectively evaluated for impairment	$604,021	$ 109,523	$ 18,950	$1,179,342	$ 31,041	$1,942,877
Loans individually evaluated for impairment	$6,778	$ 26	$ -	$3,764	$ 85	$10,653
Loans acquired with deteriorated credit quality	$78	$ 321	$ -	$496	$ -	$895

	Commercial and industrial	**Construction and development excluding undeveloped land**	**Undeveloped land**	**Real estate mortgage**	**Consumer**	**Unallocated**	**Total**
Allowance for loan losses							
At December 31, 2014	$ 11,819	$ 721	$ 1,545	$ 10,541	$ 294	$ -	$24,920
Provision (credit)	(214)	599	(1,327)	844	98	-	-
Charge-offs	(3,346)	-	-	(688)	(447)	-	(4,481)
Recoveries	47	-	650	118	360	-	1,175
At September 30, 2015	$ 8,306	$ 1,320	$ 868	$ 10,815	$ 305	$ -	$21,614
Allowance for loans collectively evaluated for impairment	$ 7,089	$ 1,320	$ 868	$ 10,499	$ 235	$ -	$20,011

Allowance for loans individually evaluated for impairment	$ 1,217	$ -	$ -	$ 316	$ 70	$ -	$ 1,603
Allowance for loans acquired with deteriorated credit quality	$ -	$ -	$ -	$ -	$ -	$ -	$ -

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Stock Yards Bancorp, inc. and subsidiary

(in thousands)	Type of loan					
December 31, 2014	**Commercial and industrial**	**Construction and development excluding undeveloped land**	**Undeveloped land**	**Real estate mortgage**	**Consumer**	**Total**
Loans	$571,754	$ 95,733	$ 21,268	$1,150,399	$ 29,396	$1,868,550
Loans collectively evaluated for impairment	$564,443	$ 94,603	$ 21,268	$1,146,212	$ 29,311	$1,855,837
Loans individually evaluated for impairment	$7,239	$ 516	$ -	$3,720	$ 76	$11,551
Loans acquired with deteriorated credit quality	$72	$ 614	$ -	$467	$ 9	$1,162

	Commercial and industrial	Construction and development excluding undeveloped land	Undeveloped land	Real estate mortgage	Consumer	Unallocated	Total
Allowance for loan losses							
At December 31, 2013	$ 7,644	$ 2,555	$ 5,376	$ 12,604	$ 343	$ -	$28,522
Provision (credit)	4,593	(1,584)	(2,244)	(1,190)	25	-	(400)
Charge-offs	(661)	(250)	(1,753)	(993)	(587)	-	(4,244)
Recoveries	243	-	166	120	513	-	1,042
At December 31, 2014	$ 11,819	$ 721	$ 1,545	$ 10,541	$ 294	$ -	$24,920
Allowance for loans collectively evaluated for impairment	$ 10,790	$ 706	$ 1,545	$ 10,285	$ 218	$ -	$23,544
Allowance for loans individually evaluated for impairment	$ 1,029	$ 15	$ -	$ 256	$ 76	$ -	$1,376
	$ -	$ -	$ -	$ -	$ -	$ -	$-

Allowance for loans acquired with deteriorated credit quality

The considerations by Bancorp in computing its allowance for loan losses are determined based on the 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 the cash flows of the business. A weakened economy and resultant decreased consumer and/or business spending will have an effect on the 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 commercial development projects. In most cases, construction loans require only interest to be paid 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 including any pre-sold 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.

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Undeveloped land: Loans in this category are secured by land initially acquired for development by the borrower, but for which no development has yet taken place. Credit risk is affected by market conditions and time to sell lots at an adequate price. Credit risk is also affected by availability of permanent financing, to the extent such permanent financing is not being provided by Bancorp.

Real estate mortgage: Loans in this category are made to and secured by owner-occupied residential real estate, owner-occupied real estate used for business purposes, and income-producing investment properties. Repayment is dependent on credit quality of the individual borrower. Underlying properties are generally located in Bancorp’s primary market area. Cash flows of income producing investment properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on credit quality. Overall health of the economy, including unemployment rates and 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, sale of collateral securing the loan. Therefore, overall health of the economy, including unemployment rates and stock prices, will have a significant effect on credit quality in this loan category.

Bancorp has loans that were acquired in a 2013 acquisition, 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, 2015 and December 31, 2014. Changes in the fair value adjustment for acquired impaired loans are shown in the following table:

(in thousands)	**Accretable discount**	**Non-accretable discount**
Balance at December 31, 2013	$ 137	$ 369
Accretion	(75)	(103)
Reclassifications from (to) non-accretable discount	-	-
Disposals	-	-
Balance at December 31, 2014	62	266
Accretion	(53)	(74)

Reclassifications from (to) non-accretable discount	-	-
Disposals	-	-
Balance at September 30, 2015	$ 9	$ 192

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The following table presents loans individually evaluated for impairment as of September 30, 2015 and December 31, 2014.

(in thousands) **September 30, 2015**	**Recorded investment**	**Unpaid principal balance**	**Related allowance**	**Average recorded investment**
Loans with no related allowance recorded				
Commercial and industrial	$ 1,545	$ 4,245	$ -	$ 988
Construction and development, excluding undeveloped land	26	151	-	26
Undeveloped land	-	-	-	-
Real estate mortgage				
Commercial investment	285	542	-	154
Owner occupied commercial	1,603	2,040	-	1,591
1-4 family residential	316	316	-	600
Home equity - first lien	91	91	-	43
Home equity - junior lien	37	37	-	64
Subtotal: Real estate mortgage	2,332	3,026	-	2,452
Consumer	15	15	-	4
Subtotal	$ 3,918	$ 7,437	$ -	$ 3,470
Loans with an allowance recorded				
Commercial and industrial	$ 5,233	$ 6,804	$ 1,217	$ 5,387
Construction and development, excluding undeveloped land	-	-	-	368
Undeveloped land	-	-	-	-
Real estate mortgage				
Commercial investment	-	-	-	92
Owner occupied commercial	1,432	1,432	316	1,328
1-4 family residential	-	-	-	188
Home equity - first lien	-	-	-	-
Home equity - junior lien	-	-	-	-
Subtotal: Real estate mortgage	1,432	1,432	316	1,608
Consumer	70	70	70	73
Subtotal	$ 6,735	$ 8,306	$ 1,603	$ 7,436

Total				
Commercial and industrial	$ 6,778	$ 11,049	$ 1,217	$ 6,375
Construction and development, excluding undeveloped land	26	151	-	394
Undeveloped land	-	-	-	-
Real estate mortgage	-	-	-	-
Commercial investment	285	542	-	246
Owner occupied commercial	3,035	3,472	316	2,919
1-4 family residential	316	316	-	788
Home equity - first lien	91	91	-	43
Home equity - junior lien	37	37	-	64
Subtotal: Real estate mortgage	3,764	4,458	316	4,060
Consumer	85	85	70	77
Total	$ 10,653	$ 15,743	$ 1,603	$ 10,906

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(in thousands) **December 31, 2014**	**Recorded investment**	**Unpaid principal balance**	**Related allowance**	**Average recorded investment**
Loans with no related allowance recorded				
Commercial and industrial	$ 896	$ 3,596	$ -	$ 996
Construction and development, excluding undeveloped land	26	151	-	26
Undeveloped land	-	-	-	5,608
Real estate mortgage				
Commercial investment	113	113	-	198
Owner occupied commercial	1,784	2,221	-	1,939
1-4 family residential	870	870	-	782
Home equity - first lien	-	-	-	11
Home equity - junior lien	36	36	-	69
Subtotal: Real estate mortgage	2,803	3,240	-	2,999
Consumer	-	-	-	-
Subtotal	$ 3,725	$ 6,987	$ -	$ 9,629
Loans with an allowance recorded				
Commercial and industrial	$ 6,343	$ 7,914	$ 1,029	$ 6,797
Construction and development, excluding undeveloped land	490	490	15	196
Undeveloped land	-	-	-	-
Real estate mortgage				
Commercial investment	122	122	-	640
Owner occupied commercial	716	716	112	704
1-4 family residential	79	79	144	651
Home equity - first lien	-	-	-	-
Home equity - junior lien	-	-	-	-
Subtotal: Real estate mortgage	917	917	256	1,995
Consumer	76	76	76	80
Subtotal	$ 7,826	$ 9,397	$ 1,376	$ 9,068
Total				
Commercial and industrial	$ 7,239	$ 11,510	$ 1,029	$ 7,793
Construction and development, excluding undeveloped land	516	641	15	222
Undeveloped land	-	-	-	5,608

Real estate mortgage	-	-	-	-
Commercial investment	235	235	-	838
Owner occupied commercial	2,500	2,937	112	2,643
1-4 family residential	949	949	144	1,433
Home equity - first lien	-	-	-	11
Home equity - junior lien	36	36	-	69
Subtotal: Real estate mortgage	3,720	4,157	256	4,994
Consumer	76	76	76	80
Total	$ 11,551	$ 16,384	$ 1,376	$ 18,697

Differences between recorded investment amounts and unpaid principal balance amounts less related allowance are due to partial charge-offs which have occurred over the life of loans.

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Impaired loans include non-accrual loans and accruing loans accounted for as troubled debt restructurings (TDR), 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. Loans past due more than 90 days and still accruing interest amounted to $544 thousand and $329 thousand at September 30, 2015 and December 31, 2014, respectively.

The following table presents the recorded investment in non-accrual loans as of September 30, 2015 and December 31, 2014.

(in thousands)	**September 30, 2015**	**December 31, 2014**
Commercial and industrial	$ 5,769	$ 1,381
Construction and development, excluding undeveloped land	26	516
Undeveloped land	-	-
Real estate mortgage		
Commercial investment	285	235
Owner occupied commercial	3,035	2,081
1-4 family residential	316	950
Home equity - first lien	91	-
Home equity - junior lien	37	36
Subtotal: Real estate mortgage	3,764	3,302
Consumer	15	-
Total	$ 9,574	$ 5,199

At September 30, 2015 and December 31, 2014, Bancorp had accruing loans classified as TDR of $1.1 million and $6.4 million, respectively. Bancorp did not modify and classify any additional loans as TDR during the nine months ended September 30, 2015 or 2014.

Bancorp had no loans accounted for as TDR that were restructured and subsequently experienced a payment default within the previous 12 months as of September 30, 2015 or 2014.

Loans accounted for as TDR 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 TDR, which have not defaulted, are individually evaluated for impairment and, at September 30, 2015, had a total allowance allocation of $188 thousand, compared to $703 thousand at December 31, 2014.

At September 30, 2015, Bancorp did not have any outstanding commitments to lend additional funds to borrowers whose loans have been modified as TDR, compared to $458 thousand at December 31, 2014.

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The following table presents the aging of the recorded investment in loans as of September 30, 2015 and December 31, 2014.

(in thousands) **September 30, 2015**	**30-59 days past due**	**60-89 days past due**	**90 or more days past due (includes) non-accrual)**	**Total past due**	**Current**	**Total loans**	**Recorded investment > 90 days and accruing**
Commercial and industrial	$26	$25	$ 5,769	$5,820	$605,057	$610,877	$ -
Construction and development, excluding undeveloped land	-	-	26	26	109,844	109,870	-
Undeveloped land	-	-	-	-	18,950	18,950	-
Real estate mortgage							
Commercial investment	427	-	285	712	490,459	491,171	-
Owner occupied commercial	268	114	3,035	3,417	354,211	357,628	-
1-4 family residential	814	734	860	2,408	220,235	222,643	544
Home equity - first lien	17	72	91	180	49,757	49,937	-
Home equity - junior lien	62	126	37	225	61,998	62,223	-
Subtotal: Real estate mortgage	1,588	1,046	4,308	6,942	1,176,660	1,183,602	544
Consumer	36	-	15	51	31,075	31,126	-
Total	$1,650	$1,071	$ 10,118	$12,839	$1,941,586	$1,954,425	$ 544
December 31, 2014							
Commercial and industrial	$3,860	$3	$ 1,382	$5,245	$566,509	$571,754	$ 1
Construction and development, excluding undeveloped land	69	-	757	826	94,907	95,733	241
Undeveloped land	-	-	-	-	21,268	21,268	-
Real estate mortgage							
Commercial investment	993	249	235	1,477	486,345	487,822	-
Owner occupied commercial	1,272	920	2,081	4,273	336,709	340,982	-
1-4 family residential	1,801	285	1,023	3,109	208,439	211,548	73
Home equity - first lien	-	-	14	14	43,765	43,779	14

Home equity - junior lien	470	78	36	584	65,684	66,268	
Subtotal: Real estate mortgage	4,536	1,532	3,389	9,457	1,140,942	1,150,399	87
Consumer	43	18	-	61	29,335	29,396	-
Total	$8,508	$1,553	$ 5,528	$15,589	$1,852,961	$1,868,550	$ 329

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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 include all risk-rated loans other than those classified as special mention, substandard, substandard non-performing and doubtful, which are defined below:

Special Mention: Loans classified as special mention have a potential weakness that deserves 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. They are characterized by the distinct possibility that Bancorp will sustain some loss if the 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.

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

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As of September 30, 2015 and December 31, 2014, the internally assigned risk grades of loans by category were as follows:

(in thousands) **September 30, 2015**	**Pass**	**Special mention**	**Substandard**	**Substandard non-performing**	**Doubtful**	**Total loans**
Commercial and industrial	$591,923	$9,946	$ 2,230	$ 6,778	$ -	$610,877
Construction and development, excluding undeveloped land	106,558	2,945	341	26	-	109,870
Undeveloped land	18,273	520	157	-	-	18,950
Real estate mortgage						
Commercial investment	484,638	5,755	493	285	-	491,171
Owner occupied commercial	340,032	12,038	2,523	3,035	-	357,628
1-4 family residential	220,287	1,496	-	860	-	222,643
Home equity - first lien	49,846	-	-	91	-	49,937
Home equity - junior lien	61,968	97	121	37	-	62,223
Subtotal: Real estate mortgage	1,156,771	19,386	3,137	4,308	-	1,183,602
Consumer	31,041	-	-	85	-	31,126
Total	$1,904,566	$32,797	$ 5,865	$ 11,197	$ -	$1,954,425
December 31, 2014						
Commercial and industrial	$546,582	$6,215	$ 11,717	$ 7,240	$ -	$571,754
Construction and development, excluding undeveloped land	88,389	4,867	1,720	757	-	95,733
Undeveloped land	20,578	530	160	-	-	21,268
Real estate mortgage						
Commercial investment	482,415	4,991	181	235	-	487,822
Owner occupied commercial	328,385	6,942	3,156	2,499	-	340,982
1-4 family residential	209,396	1,129	-	1,023	-	211,548
Home equity - first lien	43,765	-	-	14	-	43,779
Home equity - junior lien	66,182	50	-	36	-	66,268
Subtotal: Real estate mortgage	1,130,143	13,112	3,337	3,807	-	1,150,399
Consumer	29,244	76	-	76	-	29,396

Total	$1,814,936	$24,800	$ 16,934	$ 11,880	$ -	$1,868,550

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(4) 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 $67.6 million and $69.6 million at September 30, 2015 and December 31, 2014, respectively. Bancorp enters into sales of securities under agreement to repurchase at a specified future date. At September 30, 2015, 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 and under the control of Bancorp.

(5) Federal Home Loan Bank Advances

Bancorp had outstanding borrowings of $43.7 million and $36.8 million at September 30, 2015 and December 31, 2014, respectively, via twelve separate fixed-rate advances. 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 $13.7 million, principal and interest payments are due monthly based on an amortization schedule.

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

(In thousands)	**September 30, 2015**		**December 31, 2014**	
	Advance	**Rate**	**Advance**	**Rate**
2015	$30,000	2.33%	$30,000	2.30%
2020	1,850	2.23%	1,885	2.23%
2021	446	2.12%	497	2.12%
2024	2,916	2.36%	3,064	2.36%
2025	7,132	2.44%	-	-
2028	1,355	1.47%	1,386	1.47%
	$43,699	2.32%	$36,832	2.27%

Advances from the FHLB are collateralized by certain commercial and residential real estate mortgage loans totaling $568.9 million under a blanket mortgage collateral agreement and FHLB stock. Bancorp believes these borrowings to be an effective alternative to higher cost time deposits to manage interest rate risk associated with long-term fixed rate loans. At September 30, 2015, the amount of available credit from the FHLB totaled $408.1 million.

(6) Derivative Financial Instruments

Occasionally, Bancorp enters into free-standing interest rate swaps for the benefit of its commercial customers who desire to hedge their exposure to changing interest rates. Bancorp offsets its interest rate exposure on these transactions by entering into offsetting swap agreements with substantially matching terms with approved reputable independent counterparties. These undesignated derivative instruments 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 2015 were offsetting and therefore had no net effect on Bancorp’s earnings or cash flows.

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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 exposures. Direct credit exposure is limited to the net difference between the 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 the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail their obligations.

At September 30, 2015 and December 31, 2014, Bancorp had outstanding undesignated interest rate swap contracts as follows:

(dollar amounts in thousands)	**Receiving**		**Paying**	
	September 30, 2015	**December 31, 2014**	**September 30, 2015**	**December 31, 2014**
Notional amount	$8,192	$ 7,217	$8,192	$ 7,217
Weighted average maturity (years)	6.8	6.8	6.8	6.8
Fair value	$(487)	$ (401)	$487	$ 401

In 2013, 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, 2013 and ends December 6, 2016. In the third quarter of 2015, Bancorp entered into a forward starting interest rate swap to hedge cash flows of a $20 million rolling fixed-rate three-month FHLB borrowing. The start of this borrowing strategy coincides with the maturity and refinance of a current $20 million advance included in Note 5. The swap begins December 9, 2015 and matures December 6, 2020. For purposes of hedging, the rolling fixed rate advances are considered to be floating rate liabilities. The 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. The following table details Bancorp’s derivative position designated as a cash flow hedge, and the fair values as of September 30, 2015 and December 31, 2014.

(dollars in thousands)

Notional amount	Maturity date	Receive (variable) index	Pay fixed swap rate	Fair value September 30, 2015	Fair value December 31, 2014
$ 10,000	12/6/2016	US 3 Month LIBOR	0.715 %	$ (21)	$ 24
20,000	12/6/2020	US 3 Month LIBOR	1.790 %	(340)	NA
$ 30,000			1.432 %	$ (361)	$ 24

(7) 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. Annual 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.

In 2013, Bancorp completed the acquisition of THE BANCorp, Inc., parent company of THE BANK – Oldham County, Inc. As a result, Bancorp recorded a core deposit intangible totaling $2.5 million which is being amortized over the expected life of the underlying deposits to which the intangible is attributable. For money market, savings and interest bearing checking accounts, this intangible asset is being amortized using a straight line method over 15 years. For the remainder of deposits, it is being amortized over a 10-year period using an accelerated method which anticipates the life of the underlying deposits. At September 30, 2015, the unamortized core deposit intangible was $1.7 million.

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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 September 30, 2015 and December 31, 2014 were $2.5 million and $3.4 million, respectively. Total outstanding principal balances of loans serviced for others were $413.5 million and $421.1 million at September 30, 2015, and December 31, 2014, respectively.

Changes in the net carrying amount of MSRs for the nine months ended September 30, 2015 and 2014 are shown in the following table:

	For nine months ended September 30,	
(in thousands)	**2015**	**2014**
Balance at beginning of period	$1,131	$1,832
Additions for mortgage loans sold	306	197
Amortization	(569)	(713)
Balance at September 30	$868	$1,316

(8) 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. The retired officer and one current officer are fully vested, and one current officer will be fully vested in 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 $36 thousand and $32 thousand, for the three months ended September 30, 2015 and 2014, respectively. For the nine months ended September 30, 2015 and 2014, the net periodic benefit costs totaled $107 thousand and $95 thousand, respectively.

(9) Commitments and Contingent Liabilities

As of September 30, 2015, 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, commitments to extend credit of $574.6 million including standby letters of credit of $11.0 million represent normal banking transactions. Commitments to extend credit were $463.0 million, including letters of credit of $11.0 million, as of December 31, 2014. Commitments to extend credit are agreements 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 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, 2015, Bancorp has accrued $372 thousand in other liabilities for inherent risks related to unfunded credit commitments.

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

Also, as of September 30, 2015, in the normal course of business, there were pending legal actions and proceedings in which claims for damages are asserted. Management, after discussion with legal counsel, believes the ultimate result of these legal actions and proceedings will not have a material adverse effect on the consolidated financial position or results of operations of Bancorp.

(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.

(11) 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 2005 plan for future awards under the 2015 plan. No additional shares were made available. As of September 30, 2015, there were 362,985 shares available for future awards. The 2005 Stock Incentive Plan expired in April 2015; however, options and SARs granted under this plan expire as late as 2025.

Options, which have not been granted since 2007, generally had a vesting schedule of 20% per year. Stock appreciation rights (“SARs”) granted have a vesting schedule of 20% per year. Options and SARs expire ten years after the grant date unless forfeited due to employment termination.

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 are entitled to dividend payments during the vesting period. For grants in 2015, forfeitable dividends are deferred until shares are vested. Fair value of restricted shares is equal to the market value of the shares on the date of grant.

Grants of performance stock units (“PSUs”) vest based upon service and a single 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, fair value of these PSUs is estimated based upon fair value of underlying shares on the date of grant, adjusted for non-payment of dividends.

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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 estimated based on 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:

(in thousands)	**For three months ended September 30,**		**For nine months ended September 30,**	
	2015	**2014**	**2015**	**2014**
Stock-based compensation expense before income taxes	$566	$691	$1,561	$1,459
Less: deferred tax benefit	(198)	(242)	(546)	(510)
Reduction of net income	$368	$449	$1,015	$949

Bancorp expects to record an additional $514 thousand of stock-based compensation expense in 2015 for equity grants outstanding as of September 30, 2015. As of September 30, 2015, Bancorp has $4.1 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 received cash of $2.0 million and $1.4 million from the exercise of options during the first nine months of 2015 and 2014, respectively.

Fair values of Bancorp's stock options and 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 the input of assumptions, changes to which can materially affect the fair value estimate. Fair value of restricted shares is determined by 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:

	2015	**2014**

Dividend yield	2.97 %	2.94 %
Expected volatility	22.81%	23.66%
Risk free interest rate	1.91 %	2.22 %
Expected life of SARs (in years)	7.5	7.0

Dividend yield and expected volatility are based on historical information for Bancorp corresponding to the expected life of options and SARs granted. Expected volatility is the volatility of the underlying shares for the expected term 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 options. The expected life of SARs is based on actual experience of past like-term SARs and options. Bancorp evaluates historical exercise and post-vesting termination behavior when determining the expected life.

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Stock Yards Bancorp, inc. and subsidiary

A summary of stock option and SARs activity and related information for the nine months ended September 30, 2015 follows:

	Options and SARs (in thousands)	Exercise price	Weighted average exercise price	Aggregate intrinsic value (in thousands)	Weighted average fair value	Weighted average remaining contractual life (in years)
At December 31, 2014						
Vested and exercisable	524	$21.03-26.83	$ 23.84	$ 4,981	$ 5.35	3.5
Unvested	194	21.03-29.16	24.83	1,650	4.57	7.7
Total outstanding	718	21.03-29.16	24.11	6,631	5.14	4.6
Granted	50	34.43-36.83	34.48	76	5.95	
Exercised	(102)	21.03-26.83	24.22	1,186	5.72	
Forfeited	-	-	-	-	-	
At September 30, 2015						
Vested and exercisable	489	21.03-29.16	24.38	5,974	5.17	3.6
Unvested	177	22.86-36.83	27.99	1,411	4.93	7.9
Total outstanding	666	21.03-36.83	26.19	$ 7,385	5.11	4.7
Vested year-to-date	67	21.03-29.16	23.77	$ 817	4.65	

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.

For the periods ending December 31, 2014 and September 30, 2015, Bancorp granted shares of restricted common stock as outlined in the following table:

	Number	Grant date weighted-average cost
Unvested at December 31, 2013	124,556	$ 22.77
Shares awarded	39,730	29.12
Restrictions lapsed and shares released to employees/directors	(44,724)	22.69
Shares forfeited	(5,469)	23.77
Unvested at December 31, 2014	114,093	$ 24.95
Shares awarded	34,990	34.43
Restrictions lapsed and shares released to employees/directors	(40,510)	23.84
Shares forfeited	(3,766)	28.11
Unvested at September 30, 2015	104,807	$ 28.44

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Bancorp awarded performance-based restricted stock units ("PSUs") to executive officers of Bancorp, the single three-year performance period for which began January 1 of the award year. The following table outlines the PSU grants.

Grant year	Vesting period in years	Fair value	Expected shares to be awarded
2013	3	$20.38	36,792
2014	3	26.42	29,181
2015	3	31.54	19,774

In the first quarter of 2015, Bancorp awarded 6,080 RSUs to directors of Bancorp with a grant date fair value of $200 thousand. In the second quarter of 2015, 760 RSUs were cancelled, leaving 5,320 RSUs outstanding with a grant date fair value of $175 thousand.

(12) Net Income Per Share

The following table reflects, for the three and nine months ended September 30, 2015 and 2014, net income (numerator) and average shares outstanding (denominator) for basic and diluted net income per share computations:

(In thousands, except per share data)	Three months ended September 30		Nine months ended September 30	
	2015	2014	2015	2014
Net income	$9,284	$9,889	$27,541	$26,100
Average shares outstanding	14,754	14,574	14,704	14,542

Dilutive securities	232	174	236	190
Average shares outstanding including dilutive securities including dilutive securities	14,986	14,748	14,940	14,732
Net income per share, basic	$0.63	$0.68	$1.87	$1.79
Net income per share, diluted	$0.62	$0.67	$1.84	$1.77

(13) Segments

Bancorp's principal activities include commercial banking and investment management and trust. 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. Investment management and trust provides wealth management services including investment management, trust and estate administration, and retirement plan services.

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Stock Yards Bancorp, inc. and subsidiary

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.

Selected financial information by business segment for the three and nine month periods ended September 30, 2015 and 2014 follows:

(in thousands)	**Commercial banking**	**Investment management and trust**	**Total**
Three months ended September 30, 2015			
Net interest income	$ 22,034	$ 47	$22,081
Provision for loan losses	-	-	-
Investment management and trust services	-	4,373	4,373
All other non-interest income	5,612	-	5,612
Non-interest expense	15,785	2,645	18,430
Income before income taxes	11,861	1,775	13,636
Tax expense	3,720	632	4,352
Net income	$ 8,141	$ 1,143	$9,284
Three months ended September 30, 2014			
Net interest income	$ 21,317	$ 46	$21,363
Provision (credit) for loan losses	(2,100)	-	(2,100)
Investment management and trust services	-	4,502	4,502
All other non-interest income	5,348	-	5,348
Non-interest expense	15,971	2,738	18,709
Income before income taxes	12,794	1,810	14,604
Tax expense	4,071	644	4,715
Net income	$ 8,723	$ 1,166	$9,889

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Stock Yards Bancorp, inc. and subsidiary

(in thousands)	Commercial banking	Investment management and trust	Total
Nine months ended September 30, 2015			
Net interest income	$ 65,350	$ 146	$65,496
Provision for loan losses	-	-	-
Investment management and trust services	-	13,576	13,576
All other non-interest income	16,301	-	16,301
Non-interest expense	46,991	8,085	55,076
Income before income taxes	34,660	5,637	40,297
Tax expense	10,749	2,007	12,756
Net income	$ 23,911	$ 3,630	$27,541
Nine months ended September 30, 2014			
Net interest income	$ 62,110	$ 136	$62,246
Provision (credit) for loan losses	(400)	-	(400)
Investment management and trust services	-	13,825	13,825
All other non-interest income	15,527	30	15,557
Non-interest expense	46,036	7,918	53,954
Income before income taxes	32,001	6,073	38,074
Tax expense	9,814	2,160	11,974
Net income	$ 22,187	$ 3,913	$26,100

(14) Income Taxes

An analysis of the difference between statutory and effective tax rates for the nine months ended September 30, 2015 and 2014 follows:

	Nine months ended September 30	
	2015	**2014**
U.S. federal statutory tax rate	35.0 %	35.0 %
Tax exempt interest income	(1.4)	(1.5)

Tax credits	(2.4)	(1.5)
Cash surrender value of life insurance	(0.6)	(1.3)
State income taxes, net of federal benefit	0.8	0.9
Other, net	0.3	(0.2)
Effective tax rate	31.7%	31.4%

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

US GAAP provides guidance on financial statement recognition and measurement of tax positions taken, or expected to be taken, in tax returns. As of September 30, 2015 and December 31, 2014, the gross amount of unrecognized tax benefits, including penalties and interest, was $51 thousand and $42 thousand, respectively. 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. Federal and state income tax returns are subject to examination for the years after 2011.

Stock Yards Bancorp, inc. and subsidiary

(15) 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 reliability 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.

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 maximization of use of observable inputs and minimization of 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.