S Y BANCORP INC
Form 10-Q
November 08, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended September 30, 2007

OR

o	**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

S.Y. 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 x No o

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

Large accelerated filer **o** **Accelerated filer** **x** **Non-accelerated filer** **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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock, no par value 13,829,887

Shares issued and outstanding at November 1, 2007

S.Y. BANCORP, INC. AND SUBSIDIARY

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

The following consolidated financial statements of S.Y. Bancorp, Inc. and Subsidiary, Stock Yards Bank & Trust Company, are submitted herewith:

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

Item 6. Exhibits

S.Y. BANCORP, INC. AND SUBSIDIARY

Condensed Consolidated Balance Sheets

September 30, 2007 and December 31, 2006

(In thousands, except share data)

	(Unaudited) September 30, 2007	December 31, 2006
Assets		
Cash and due from banks	$ 32,900	$ 44,007
Federal funds sold	978	15,671
Mortgage loans held for sale	3,096	4,035
Securities available for sale (amortized cost of $145,699 in 2007 and $146,859 in 2006)	145,628	145,695
Securities held to maturity (fair value of $2,091 in 2007 and $3,159 in 2006)	2,091	3,148
Federal Home Loan Bank stock	3,797	3,591
Loans	1,156,899	1,148,954
Less allowance for loan losses	12,550	12,203
Net loans	1,144,349	1,136,751
Premises and equipment, net	25,063	24,823
Accrued interest receivable and other assets	52,551	48,600
Total assets	$ 1,410,453	$ 1,426,321
Liabilities and Stockholders Equity		
Deposits:		
Non-interest bearing	$ 167,614	$ 179,657
Interest bearing	899,815	923,585
Total deposits	1,067,429	1,103,242
Securities sold under agreements to repurchase and federal funds purchased	93,280	84,313
Other short-term borrowings	1,001	734
Accrued interest payable and other liabilities	40,030	40,468
Federal Home Loan Bank advances	70,000	60,000
Subordinated debentures	90	120
Total liabilities	1,271,830	1,288,877
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 14,004,897 and 14,400,420 shares in 2007 and 2006, respectively	7,564	8,878
Additional paid-in capital	18,424	27,703
Retained earnings	112,943	101,876
Accumulated other comprehensive loss	(308)	(1,013)
Total stockholders equity	138,623	137,444
Total liabilities and stockholders equity	$ 1,410,453	$ 1,426,321

See accompanying notes to unaudited condensed consolidated financial statements.

S.Y. BANCORP, INC. AND SUBSIDIARY

Unaudited Condensed Consolidated Statements of Income

For the three and nine months ended September 30, 2007 and 2006

(In thousands, except per share data)

	For three months ended September 30, 2007	For three months ended September 30, 2006	For nine month ended September 30, 2007	For nine month ended September 30, 2006
Interest income:				
Loans	$ 21,290	$ 20,402	$ 63,164	$ 58,429
Federal funds sold	168	206	756	771
Mortgage loans held for sale	57	66	181	177
Securities taxable	1,284	1,047	3,560	3,297
Securities tax-exempt	263	308	822	926
Total interest income	23,062	22,029	68,483	63,600
Interest expense:				
Deposits	7,855	7,188	23,540	19,753
Securities sold under agreements to repurchase and federal funds purchased	799	642	2,151	1,628
Other short-term borrowings	11	278	17	296
Federal Home Loan Bank advances	854	312	2,236	959
Subordinated debentures	2	2	5	934
Total interest expense	9,521	8,422	27,949	23,570
Net interest income	13,541	13,607	40,534	40,030
Provision for loan losses	850	450	2,090	1,400
Net interest income after provision for loan losses	12,691	13,157	38,444	38,630
Non-interest income:				
Investment management and trust services	3,227	2,882	9,760	8,600
Service charges on deposit accounts	2,260	2,188	6,482	6,596
Bankcard transaction revenue	596	509	1,728	1,495
Gains on sales of mortgage loans held for sale	227	326	874	933
Gains on sales of securities available for sale				
Brokerage commissions and fees	498	460	1,443	1,559
Other	758	644	2,159	1,968
Total non-interest income	7,566	7,009	22,446	21,151
Non-interest expenses:				
Salaries and employee benefits	6,865	6,356	20,104	19,800
Net occupancy expense	917	899	2,737	2,608
Data processing expense	979	929	3,045	2,819
Furniture and equipment expense	291	285	873	888
Amortization and writeoff of issuance costs of trust preferred		879		897
State bank taxes	326	327	815	971
Other	2,149	2,238	6,811	6,986
Total non-interest expenses	11,527	11,913	34,385	34,969
Income before income taxes	8,730	8,253	26,505	24,812
Income tax expense	2,843	2,832	8,617	8,203
Net income	$ 5,887	$ 5,421	$ 17,888	$ 16,609
Net income per share:				
Basic	$ 0.42	$ 0.38	$ 1.25	$ 1.15
Diluted	0.41	0.37	1.23	1.13
Average common shares:				
Basic	14,185	14,426	14,299	14,471

Diluted	14,400	14,718	14,525	14,736

See accompanying notes to unaudited condensed consolidated financial statements.

S.Y. BANCORP, INC. AND SUBSIDIARY

Unaudited Condensed Consolidated Statements of Cash Flows

For the nine months ended September 30, 2007 and 2006

(In thousands)

	2007	2006
Operating activities:		
Net income	$ 17,888	$ 16,609
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,090	1,400
Depreciation, amortization and accretion, net	1,930	2,264
Amortization and writeoff of issuance costs of trust preferred		897
Provision for deferred income taxes	(505)	(442)
Gain on sales of securities available for sale		
Gains on sales of mortgage loans held for sale	(874)	(933)
Origination of mortgage loans held for sale	(59,917)	(66,568)
Proceeds from sale of mortgage loans held for sale	61,730	70,876
Loss on the sale of premises and equipment		13
Bank owned life insurance income	733	674
Loss (gain) on the sales of other real estate	28	(15)
Stock compensation expense	386	469
Excess tax benefits from share-based compensation arrangements	(33)	(297)
Increase in accrued interest receivable and other assets	(10,964)	(3,227)
Decrease in accrued interest payable and other liabilities	(3)	(902)
Net cash provided by operating activities	12,489	20,818
Investing activities:		
Purchases of securities available for sale	(62,029)	(40,618)
Proceeds from maturities of securities available for sale	62,985	69,744
Proceeds from maturities of securities held to maturity	1,054	725
Net increase in loans	(6,946)	(63,921)
Purchases of premises and equipment	(2,169)	(2,013)
Proceeds from sales of other real estate	3,122	567
Net cash used in investing activities	(3,983)	(35,516)
Financing activities:		
Net (decrease) increase in deposits	(35,813)	35,607
Net increase in securities sold under agreements to repurchase and federal funds purchased	8,967	11,918
Net increase (decrease) in other short-term borrowings	267	(929)
Proceeds from Federal Home Loan Bank advances	20,000	
Repayments of Federal Home Loan Bank advances	(10,000)	(10,000)
Repayments of subordinated debentures	(30)	(20,649)
Issuance of common stock for options and dividend reinvestment plan	1,089	1,534
Excess tax benefits from share-based compensation arrangements	33	297
Common stock repurchases	(12,211)	(3,993)
Cash dividends paid	(6,608)	(5,778)
Net cash (used in) provided by financing activities	(34,306)	8,007
Net decrease in cash and cash equivalents	(25,800)	(6,691)
Cash and cash equivalents at beginning of period	59,678	44,039
Cash and cash equivalents at end of period	$ 33,878	$ 37,348
Supplemental cash flow information:		
Income tax payments	$ 7,570	$ 5,860
Cash paid for interest	27,371	23,600
Supplemental non-cash activity:		

Transfers from loans to other real estate owned	$	2,742	$	824

See accompanying notes to unaudited condensed consolidated financial statements.

S.Y. BANCORP, INC. AND SUBSIDIARY

Unaudited Condensed Consolidated Statement of Changes in Stockholders Equity

For the nine months ended September 30, 2007

(In thousands, except per share data)

	Common stock Number of shares	Common stock Amount	Additional Paid in Capital	Retained earnings	Accumulated other comprehensive loss	Total
Balance December 31, 2006	14,400	$ 8,878	$ 27,703	$ 101,876	$ (1,013)	$ 137,444
Net income				17,888		17,888
Change in accumulated other comprehensive loss, net of tax					705	705
Stock compensation expense			386			386
Stock issued for stock options exercised and dividend reinvestment plan	77	257	865			1,122
Stock issued for non- vested restricted stock	4	14	96	(110)		
Cash dividends, $0.47 per share				(6,711)		(6,711)
Shares repurchased	(476)	(1,585)	(10,626)			(12,211)
Balance September 30, 2007	14,005	$ 7,564	$ 18,424	$ 112,943	$ (308)	$ 138,623

See accompanying notes to unaudited condensed consolidated financial statements.

S.Y. BANCORP, INC. AND SUBSIDIARY

Unaudited Condensed Consolidated Statements of Comprehensive Income

For the three and nine months ended September 30, 2007 and 2006

(In thousands)

	Three months ended September 30		Nine months ended September 30	
	2007	**2006**	**2007**	**2006**
Net income	$ 5,887	$ 5,421	$ 17,888	$ 16,609
Other comprehensive gain, net of tax:				
Unrealized gains on securities available for sale -				
Unrealized gains arising during the period (net of tax of $454, $631, $380 and $6, respectively)	844	1,171	705	11
Other comprehensive income	844	1,171	705	11
Comprehensive income	$ 6,731	$ 6,592	$ 18,593	$ 16,620

See accompanying notes to unaudited condensed consolidated financial statements.

S.Y. BANCORP, INC. AND SUBSIDIARY

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Summary of Significant Accounting Policies

The accompanying unaudited condensed 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 for complete financial statements. The consolidated financial statements of S.Y. 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 consolidated financial statements include the accounts of S.Y. Bancorp, Inc. and its wholly-owned subsidiary, Stock Yards Bank & Trust Company (Bank). Significant intercompany transactions and accounts have been eliminated in consolidation.

A description of other significant accounting policies is presented in the notes to the Consolidated Financial Statements for the year ended December 31, 2006 included in S.Y. 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, 2007 are not necessarily indicative of the results for the entire year.

(a) Critical Accounting Policies

Management has identified the accounting policy related to the allowance 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 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.

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 periodic IRS and state agency examinations, could materially impact Bancorp s financial position and its results from operations.

(b) Securities

Unrealized losses on Bancorp s bond portfolio have not been recognized in income because the bonds are of high credit quality, management has the intent and the ability to hold for the foreseeable future, and the decline in fair values is largely due to an increase in prevailing interest rates since the purchase date. The fair value is expected to recover as the securities reach their maturity date and/or interest rates decline. Bonds with gross unrealized losses consist of 61 and 69 separate investment positions as of September 30, 2007 and December 31, 2006, respectively that are not considered other-than-temporarily impaired.

(c) Stock-Based Compensation

On January 1, 2006, Bancorp adopted the modified version of prospective application of Statement of Financial Standard No. 123 (R) Share-based Payment , (SFAS No. 123R). Under this method, the fair value of all new and modified awards granted subsequent to the date of adoption will be recognized as compensation expense, net of estimated forfeitures. Further, the fair value of any unvested awards at the date of adoption was recognized as compensation expense, net of estimated forfeitures.

Bancorp s 1995 Stock Incentive Plan expired in 2005; however, options or share grants under this plan expire as late as 2015. The 2005 Stock Incentive Plan reserved 735,000 shares of common stock for issuance of stock based awards. As of September 30, 2007, there were 404,980 shares available for future awards. Options granted have been subject to a vesting schedule of 20% per year except for those granted to certain executive officers which vest six months after grant date. All outstanding options were granted at an exercise price equal to the market value of common stock at the time of grant and expire ten years after the grant date. Restricted shares granted to executive officers are subject to a vesting schedule of one-third per year. Certain other officers received grants vesting over two to five years.

The fair value of Bancorp s stock options is estimated at the date of grant using the Black-Scholes option pricing model, an accepted and widely used formula for calculating the value of stock options. This model requires the input of subjective assumptions, changes to which can materially affect the fair value estimate. As a result of applying the provisions of SFAS No. 123R, Bancorp recognized for the nine months ended September 30, 2007 and 2006, within salaries and employee benefits in the unaudited condensed consolidated income statements, stock-based compensation expense of $386,000 and $469,000 before income taxes and a deferred tax benefit of $135,000 and $164,000 resulting in a reduction of net income of $251,000 and $305,000, or $0.02, in both years, per basic and diluted shares. For the third quarter of 2007 and 2006, Bancorp recognized $144,000 and $85,000 of compensation expense before taxes, a deferred tax benefit of $50,000 and $30,000 and a reduction of net income of $94,000 and $55,000, or less than $0.01, in both years, per basic and diluted shares, respectively. Bancorp expects to record an additional $85,000 of compensation expense in 2007. As of September 30, 2007 Bancorp has $1,193,000 of unrecognized stock-based compensation expense. The remaining compensation expense related to stock options is $1,097,000, which will be recorded as expense over the next 4.25 years, the weighted-average remaining life of these options. The remaining compensation expense related to restricted shares is $96,000, which will be recorded as expense over the next 2.25 years, the weighted average remaining life of these restricted shares.

In accordance with the Financial Accounting Standards Board Staff Position SFAS No. 123R 3, Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards , Bancorp has elected the alternative transition method to calculate the beginning balance of the pool of excess tax benefits. The beginning balance of excess tax benefits was calculated as the sum of all net increases in additional paid-in-capital related to tax benefits from stock-based employee compensation, less the incremental stock-based after-tax compensation costs that would have been recognized if the fair value recognition provisions of SFAS No. 123 had been used to account for stock-based compensation costs.

SFAS No. 123R requires the cash flows resulting from excess tax deductions related to the compensation costs recognized for the share-based awards be classified as financing cash inflows. Cash flows provided by financing activities relating to excess tax benefits from share-based compensation arrangements increased by $33,000 and $297,000 and cash flows used in operating activities decreased by $33,000 and $297,000 for the nine months ended September 30, 2007 and 2006, respectively.

Under SFAS No. 123R, Bancorp is required to reduce future stock-based compensation expense by estimated forfeitures at the grant date. These forfeiture estimates are based on historical experience.

The following assumptions were used in option valuations:

	2007	**2006**
Dividend yield	1.81%	1.63%
Expected volatility	14.49	16.53
Risk free interest rate	4.69	4.42
Forfeitures	5.55	5.69
Expected life of options (in years)	7.7	7.7

The expected life of options is based on actual experience of past like-term options. All outstanding options have a 10-year contractual term. Bancorp evaluated historical exercise and post-vesting termination behavior when determining the expected life of 7.7 years for options granted during the first nine months of 2007 and 2006.

The dividend yield and expected volatility are based on historical information corresponding to the expected life of options granted. The expected volatility is the volatility of the underlying shares for the expected term on a quarterly basis.

The risk free interest rate is the implied yield currently available on U. S. Treasury issues with a remaining term equal to the expected life of the options.

A summary of stock option activity and related information for the nine months ended September 30, 2007 follows. The number of options and aggregate intrinsic value are stated in thousands of dollars.

(In thousands, except per share data)	Options	Exercise Price	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Fair Value	Weighted Average Remaining Contractual Life
At December 31, 2006						
Vested and exercisable	818	$6.90-$24.07	$ 17.13	$ 14,009	$ 3.64	
Unvested	139	18.05-24.07	23.89	3,322	5.76	
Total outstanding	957	6.90-24.07	18.12	17,331	3.95	
Granted	153	24.02-26.83	26.81	4,090	6.14	
Exercised	(76)	6.90-24.07	14.18	(870)	2.86	
Forfeited	(12)	20.95-26.83	24.81	(287)	5.88	
At September 30, 2007						
Vested and exercisable	806	9.76-24.83	18.08	14,579	3.89	5.37
Unvested	216	18.05-26.83	25.43	5,487	5.96	8.85
Total outstanding	1,022	9.76-26.83	19.63	20,066	4.33	6.10
Vested during quarter	67	18.05-26.83	25.41	1,707	5.94	

In February 2007, Bancorp granted 151,550 options to purchase common stock shares at the current market price of $26.83 and a fair value of $6.14. These options were awarded to employees and will primarily vest 20% per year over the next five years. Of these options, 36,500 were granted to certain executive officers and will vest six months from the date of grant. In May 2007, Bancorp granted 1,000 options to purchase common stock shares at the current market price of $24.02 and a fair value of $6.14. All options expire ten years from the date of grant.

Also, in February 2007, Bancorp adopted a restricted stock program under the terms of the Company s 2005 Incentive Stock Plan. Bancorp granted 2,775 shares of common stock at the current market price of $26.83. Shares were granted to executive officers and will vest one-third per year over the next three years. Certain other officers received grants vesting over two to five years. In July 2007, Bancorp granted 1,500 shares of common stock at the current market price of $24.13. As of September 30, 2007, none of these restricted shares had vested or canceled.

(2) Allowance for Loan Losses

An analysis of the changes in the allowance for loan losses for the nine months ended September 30 follows (in thousands):

	2007	2006
Beginning balance January 1,	$ 12,203	$ 12,035
Provision for loan losses	2,090	1,400
Loans charged off	(2,447)	(1,733)
Recoveries	704	740
Ending balance September 30,	$ 12,550	$ 12,442

(3) Federal Home Loan Bank Advances

Under a blanket collateral agreement with the Federal Home Loan Bank of Cincinnati and secured by certain commercial and residential real estate loans, the Bank has outstanding borrowings of $70,000,000, at September 30, 2007, via three separate advances. The first two are fixed rate, non-callable advances of $20,000,000 and $30,000,000, which are due in October of 2008 and November of 2009, respectively. The third advance of $20,000,000 is a fixed rate advance eligible to be called by the FHLB after 12 months, in May of 2008, and then quarterly going forward until its maximum maturity in May of 2012. At September 30, 2007, the weighted average rate of these advances was 4.84%. Interest payments are due monthly, with principal due at maturity.

(4) Intangible Assets

Statement of Financial Accounting Standards No. 142, Goodwill and Intangible Assets (SFAS No. 142), requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually. Annual evaluations have resulted in no charges for impairment. Bancorp currently has goodwill from the acquisition of a bank in southern Indiana in the amount of $682,000. This goodwill is assigned to the commercial banking segment of Bancorp.

(5) Defined Benefit Retirement Plan

The Bank sponsors an unfunded, non-qualified, defined benefit retirement plan for certain key officers. Benefits vest based on years of service. The Bank does not make contributions to this plan. Information about the components of the net periodic benefit cost of the defined benefit plan follows:

	Three months ended September 30			
	2007		2006	
Components of net periodic benefit cost:				
Service cost	$		$	
Interest cost		28		29
Expected return on plan assets				
Amortization of prior service cost				
Amortization of the net loss		7		7
Net periodic benefit cost	$	35	$	36

	Nine months ended September 30			
	2007		2006	
Components of net periodic benefit cost:				
Service cost	$		$	
Interest cost		85		88
Expected return on plan assets				
Amortization of prior service cost				
Amortization of the net loss		20		21
Net periodic benefit cost	$	105	$	109

(6) Commitments to Extend Credit

As of September 30, 2007, 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 financial statements. In management s opinion, commitments to extend credit of $456,538,000, and standby letters of credit of $12,287,000, represent normal banking transactions, and no significant losses are anticipated to result from these commitments as of September 30, 2007. Commitments to extend credit were $359,070,000, and letters of credit were $17,044,000, as of December 31, 2006. Bancorp s exposure to credit loss in the event of nonperformance by the other party to these commitments is represented by the contractual amount of these instruments. Bancorp uses the same credit and collateral policies in making commitments and conditional guarantees as for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Commitments to extend credit are primarily made up of commercial lines of credit, construction and development loans and home equity credit lines. 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 evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by Bancorp upon extension of credit, is based on management s credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income-producing commercial properties, residential properties and real estate under development.

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 borrowing arrangements.

(7) Preferred Stock

At Bancorp s annual meeting of shareholders held in April 2003, the shareholders approved an amendment to the Articles of Incorporation to create a class of preferred stock and authorize 1,000,000 shares of this preferred stock with no par value. The relative rights, preferences and other terms of this stock or any series within the class will be determined by the Board of Directors prior to any issuance. Some of this preferred stock will be used in connection with a shareholders rights plan upon the occurrence of certain triggering events. None of this stock had been issued as of September 30, 2007.

(8) Net Income Per Share

The following table reflects, for the three and nine month periods ended September 30, 2007 and 2006, net income (the numerator) and average shares outstanding (the denominator) for the basic and diluted net income per share computations (in thousands except per share data):

	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Net income, basic and diluted	$ 5,887	$ 5,421	$ 17,888	$ 16,609
Average shares outstanding	14,185	14,426	14,299	14,471
Effect of dilutive securities	215	292	226	265
Average shares outstanding including dilutive securities	14,400	14,718	14,525	14,736
Net income per share, basic	$ 0.42	$ 0.38	$ 1.25	$ 1.15
Net income per share, diluted	$ 0.41	$ 0.37	$ 1.23	$ 1.13

(9) Segments

The Bank s, and thus Bancorp s, principal activities include commercial banking and investment management and trust. Commercial banking provides a full range of loan and deposit products to individual consumers and businesses. Commercial banking also includes the Bank s mortgage banking and brokerage activity. Investment management and trust provides wealth management services including investment management, trust and estate administration, and retirement plan services.

The financial information for each business segment reflects that which is specifically identifiable or allocated based on an internal allocation method. Principally, all of the net assets of Bancorp are involved in the commercial banking segment. Income taxes are allocated based on the effective federal tax rate. The measurement of the performance of the business segments is based on the management structure of the Bank and is not necessarily comparable with similar information for any other financial institution. The information presented is also not necessarily indicative of the segments operations, if they were independent entities.

Selected financial information by business segment for the three and nine months ended September 30, 2007 and 2006 follows:

	Three months ended September 30		Nine months ended September 30	
	2007	**2006**	**2007**	**2006**
	(In thousands)		**(In thousands)**	
Net interest income (expense):				
Commercial banking	$ 13,559	$ 13,638	$ 40,577	