

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, 2016

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

(State or other jurisdiction of  
incorporation or organization)

61-1137529

(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, 2016, was 22,575,981.

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**  
Index

| <b><u>Item</u></b>                                                                                                                           | <b><u>Page</u></b> |
|----------------------------------------------------------------------------------------------------------------------------------------------|--------------------|
| <b>PART I – FINANCIAL INFORMATION</b>                                                                                                        |                    |
| Item 1. Financial Statements                                                                                                                 |                    |
| The following consolidated financial statements of Stock Yards Bancorp, Inc. and Subsidiary are submitted herewith:                          |                    |
| <a href="#">Consolidated Balance Sheets September 30, 2016 (Unaudited) and December 31, 2015</a>                                             | 3                  |
| <a href="#">Consolidated Statements of Income (Unaudited) for the three and nine months ended September 30, 2016 and 2015</a>                | 4                  |
| <a href="#">Consolidated Statements of Comprehensive Income (Unaudited) for the three and nine months ended September 30, 2016 and 2015</a>  | 5                  |
| <a href="#">Consolidated Statements of Changes in Stockholders' Equity (Unaudited) for the nine months ended September 30, 2016 and 2015</a> | 6                  |
| <a href="#">Consolidated Statements of Cash Flows (Unaudited) the nine months ended September 30, 2016 and 2015</a>                          | 7                  |
| <a href="#">Notes to Consolidated Financial Statements (Unaudited)</a>                                                                       | 8                  |
| Item 2. <a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a>                                | 42                 |
| Item 3. <a href="#">Quantitative and Qualitative Disclosures about Market Risk</a>                                                           | 61                 |
| Item 4. <a href="#">Controls and Procedures</a>                                                                                              | 61                 |
| <b>PART II – OTHER INFORMATION</b>                                                                                                           |                    |
| Item 2. <a href="#">Unregistered Sales of Equity Securities and Use of Proceeds</a>                                                          | 62                 |
| Item 6. <a href="#">Exhibits</a>                                                                                                             | 62                 |

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**  
Index  
**PART I – FINANCIAL INFORMATION**

**Glossary of Acronyms and Terms**

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

|                |                                                           |
|----------------|-----------------------------------------------------------|
| ASU            | Accounting Standards Update                               |
| Bancorp        | Stock Yards Bancorp, Inc.                                 |
| Bank           | Stock Yards Bank & Trust Company                          |
| BOLI           | Bank Owned Life Insurance                                 |
| BP             | Basis Point = 1/100 <sup>th</sup> of one percent          |
| Dodd-Frank Act | Dodd-Frank Wall Street Reform and Consumer Protection Act |
| FASB           | Financial Accounting Standards Board                      |
| FDIC           | Federal Deposit Insurance Corporation                     |
| FHA            | Federal Housing Administration                            |
| FHLB           | Federal Home Loan Bank                                    |
| FHLMC          | Federal Home Loan Mortgage Corporation                    |
| FNMA           | Federal National Mortgage Association                     |
| GNMA           | Government National Mortgage Association                  |
| WM             | Wealth management and trust                               |
| LIBOR          | London Interbank Offered Rate                             |
| MSR            | Mortgage Servicing Right                                  |
| OAEM           | Other Assets Especially Mentioned                         |
| OREO           | Other Real Estate Owned                                   |
| PSU            | Performance Stock Unit                                    |
| RSU            | Restricted Stock Unit                                     |
| SAR            | Stock Appreciation Right                                  |
| SEC            | Securities and Exchange Commission                        |
| TDR            | Troubled Debt Restructuring                               |
| US GAAP        | United States Generally Accepted Accounting Principles    |
| VA             | U.S. Department of Veterans Affairs                       |

Item 1. Financial Statements
**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

## Consolidated Balance Sheets

September 30, 2016 (unaudited) and December 31, 2015

(In thousands, except share data)

|                                                                                                                                                  | September 30,<br>2016 | December 31,<br>2015 |
|--------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
| <b>Assets</b>                                                                                                                                    |                       |                      |
| Cash and due from banks                                                                                                                          | \$ 41,533             | \$ 35,895            |
| Federal funds sold and interest bearing deposits                                                                                                 | 16,360                | 67,938               |
| Cash and cash equivalents                                                                                                                        | 57,893                | 103,833              |
| Mortgage loans held for sale                                                                                                                     | 5,959                 | 6,800                |
| Securities available-for-sale (amortized cost of \$533,873 in 2016 and \$564,391 in 2015)                                                        | 541,681               | 565,876              |
| Federal Home Loan Bank stock and other securities                                                                                                | 6,347                 | 6,347                |
| Loans                                                                                                                                            | 2,222,706             | 2,033,007            |
| Less allowance for loan losses                                                                                                                   | 24,369                | 22,441               |
| Net loans                                                                                                                                        | 2,198,337             | 2,010,566            |
| Premises and equipment, net                                                                                                                      | 42,903                | 39,557               |
| Bank owned life insurance                                                                                                                        | 31,653                | 30,996               |
| Accrued interest receivable                                                                                                                      | 6,952                 | 6,610                |
| Other assets                                                                                                                                     | 46,940                | 46,216               |
| Total assets                                                                                                                                     | <u>\$ 2,938,665</u>   | <u>\$ 2,816,801</u>  |
| <b>Liabilities and Stockholders' Equity</b>                                                                                                      |                       |                      |
| <b>Deposits:</b>                                                                                                                                 |                       |                      |
| Non-interest bearing                                                                                                                             | \$ 680,078            | \$ 583,768           |
| Interest bearing                                                                                                                                 | 1,710,519             | 1,787,934            |
| Total deposits                                                                                                                                   | 2,390,597             | 2,371,702            |
| Securities sold under agreements to repurchase                                                                                                   | 67,315                | 64,526               |
| Federal funds purchased and other short-term borrowing                                                                                           | 76,387                | 22,477               |
| Federal Home Loan Bank advances                                                                                                                  | 51,366                | 43,468               |
| Accrued interest payable                                                                                                                         | 116                   | 127                  |
| Other liabilities                                                                                                                                | 41,314                | 27,982               |
| Total liabilities                                                                                                                                | 2,627,095             | 2,530,282            |
| <b>Stockholders' equity:</b>                                                                                                                     |                       |                      |
| Preferred stock, no par value. Authorized 1,000,000 shares; no shares issued or outstanding                                                      | —                     | —                    |
| Common stock, no par value. Authorized 40,000,000 shares; issued and outstanding 22,562,572 and 14,919,351 shares in 2016 and 2015, respectively | 36,068                | 10,616               |
| Additional paid-in capital                                                                                                                       | 24,050                | 44,180               |
| Retained earnings                                                                                                                                | 247,011               | 231,091              |
| Accumulated other comprehensive income                                                                                                           | 4,441                 | 632                  |
| Total stockholders' equity                                                                                                                       | 311,570               | 286,519              |
| Total liabilities and stockholders' equity                                                                                                       | <u>\$ 2,938,665</u>   | <u>\$ 2,816,801</u>  |

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, 2016 and 2015  
(In thousands, except per share data)

|                                                        | For three months ended<br>September 30, |           | For nine months ended<br>September 30, |           |
|--------------------------------------------------------|-----------------------------------------|-----------|----------------------------------------|-----------|
|                                                        | 2016                                    | 2015      | 2016                                   | 2015      |
| Interest income:                                       |                                         |           |                                        |           |
| Loans                                                  | \$ 23,436                               | \$ 20,924 | \$ 67,992                              | \$ 61,951 |
| Federal funds sold and interest bearing deposits       | 95                                      | 65        | 395                                    | 184       |
| Mortgage loans held for sale                           | 66                                      | 67        | 185                                    | 180       |
| Securities – taxable                                   | 2,047                                   | 1,936     | 6,325                                  | 5,939     |
| Securities – tax-exempt                                | 298                                     | 292       | 907                                    | 877       |
| Total interest income                                  | 25,942                                  | 23,284    | 75,804                                 | 69,131    |
| Interest expense:                                      |                                         |           |                                        |           |
| Deposits                                               | 941                                     | 900       | 2,916                                  | 2,811     |
| Federal funds purchased and other short-term borrowing | 19                                      | 7         | 57                                     | 19        |
| Securities sold under agreements to repurchase         | 38                                      | 42        | 100                                    | 111       |
| Federal Home Loan Bank advances                        | 184                                     | 254       | 552                                    | 694       |
| Total interest expense                                 | 1,182                                   | 1,203     | 3,625                                  | 3,635     |
| Net interest income                                    | 24,760                                  | 22,081    | 72,179                                 | 65,496    |
| Provision for loan losses                              | 1,250                                   | —         | 2,500                                  | —         |
| Net interest income after provision for loan losses    | 23,510                                  | 22,081    | 69,679                                 | 65,496    |
| Non-interest income:                                   |                                         |           |                                        |           |
| Wealth management and trust services                   | 4,800                                   | 4,373     | 14,219                                 | 13,576    |
| Service charges on deposit accounts                    | 2,544                                   | 2,342     | 6,952                                  | 6,621     |
| Bankcard transaction                                   | 1,455                                   | 1,223     | 4,198                                  | 3,591     |
| Mortgage banking                                       | 1,072                                   | 772       | 2,896                                  | 2,513     |
| Securities brokerage                                   | 558                                     | 585       | 1,539                                  | 1,545     |
| Bank owned life insurance                              | 216                                     | 222       | 657                                    | 670       |
| Other                                                  | 713                                     | 468       | 1,757                                  | 1,361     |
| Total non-interest income                              | 11,358                                  | 9,985     | 32,218                                 | 29,877    |
| Non-interest expenses:                                 |                                         |           |                                        |           |
| Salaries and employee benefits                         | 12,048                                  | 11,333    | 36,214                                 | 33,816    |
| Net occupancy                                          | 1,646                                   | 1,518     | 4,716                                  | 4,437     |
| Data processing                                        | 1,747                                   | 1,572     | 5,172                                  | 4,782     |
| Furniture and equipment                                | 277                                     | 282       | 853                                    | 789       |
| FDIC insurance                                         | 356                                     | 318       | 1,035                                  | 932       |
| Amortization of investments in tax credit partnerships | 1,015                                   | 158       | 3,046                                  | 475       |
| Other                                                  | 3,429                                   | 3,249     | 9,215                                  | 9,845     |
| Total non-interest expenses                            | 20,518                                  | 18,430    | 60,251                                 | 55,076    |
| Income before income taxes                             | 14,350                                  | 13,636    | 41,646                                 | 40,297    |
| Income tax expense                                     | 3,883                                   | 4,352     | 11,235                                 | 12,756    |
| Net income                                             | \$ 10,467                               | \$ 9,284  | \$ 30,411                              | \$ 27,541 |
| Net income per share:                                  |                                         |           |                                        |           |
| Basic                                                  | \$ 0.47                                 | \$ 0.42   | \$ 1.36                                | \$ 1.25   |
| Diluted                                                | \$ 0.46                                 | \$ 0.41   | \$ 1.34                                | \$ 1.23   |
| Average common shares:                                 |                                         |           |                                        |           |
| Basic                                                  | 22,385                                  | 22,131    | 22,325                                 | 22,056    |
| Diluted                                                | 22,803                                  | 22,479    | 22,711                                 | 22,410    |

See accompanying notes to unaudited consolidated financial statements.

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**  
Consolidated Statements of Comprehensive Income (Unaudited)  
For the three and nine months ended September 30, 2016 and 2015  
(In thousands)

|                                                                                                                       | <b>Three months ended<br/>September 30,</b> |                  | <b>Nine months ended<br/>September 30,</b> |                  |
|-----------------------------------------------------------------------------------------------------------------------|---------------------------------------------|------------------|--------------------------------------------|------------------|
|                                                                                                                       | <b>2016</b>                                 | <b>2015</b>      | <b>2016</b>                                | <b>2015</b>      |
| Net income                                                                                                            | \$ 10,467                                   | \$ 9,284         | \$ 30,411                                  | \$ 27,541        |
| Other comprehensive income, net of tax:                                                                               |                                             |                  |                                            |                  |
| Unrealized gains (losses) on securities available for sale:                                                           |                                             |                  |                                            |                  |
| Unrealized gains (losses) arising during the period (net of tax of (\$616), \$1,089, \$2,213 and \$683, respectively) | (1,147)                                     | 2,023            | 4,110                                      | 1,270            |
| Unrealized gains (losses) on hedging instruments:                                                                     |                                             |                  |                                            |                  |
| Unrealized gains (losses) arising during the period (net of tax of \$74, (\$124), (\$162) and (\$135), respectively)  | 137                                         | (231)            | (301)                                      | (250)            |
| Other comprehensive income (loss), net of tax                                                                         | (1,010)                                     | 1,792            | 3,809                                      | 1,020            |
| Comprehensive income                                                                                                  | <u>\$ 9,457</u>                             | <u>\$ 11,076</u> | <u>\$ 34,220</u>                           | <u>\$ 28,561</u> |

See accompanying notes to unaudited consolidated financial statements.

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**  
Consolidated Statements of Changes in Stockholders' Equity (Unaudited)  
For the nine months ended September 30, 2016 and 2015  
(In thousands, except per share data)

|                                                                                                               | <b>Common stock</b>         |                  | <b>Additional<br/>paid-in capital</b> | <b>Retained<br/>earnings</b> | <b>Accumulated<br/>other<br/>comprehensive<br/>income (loss)</b> | <b>Total</b>      |
|---------------------------------------------------------------------------------------------------------------|-----------------------------|------------------|---------------------------------------|------------------------------|------------------------------------------------------------------|-------------------|
|                                                                                                               | <b>Number of<br/>shares</b> | <b>Amount</b>    |                                       |                              |                                                                  |                   |
| 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 share-based awards, net of<br>withholdings to satisfy employee tax<br>obligations upon award | 145                         | 483              | 3,074                                 | (1,533)                      | —                                                                | 2,024             |
| Cash dividends, \$0.71 per share                                                                              | —                           | —                | —                                     | (10,519)                     | —                                                                | (10,519)          |
| Shares cancelled                                                                                              | (21)                        | (70)             | (609)                                 | 105                          | —                                                                | (574)             |
| Balance September 30, 2015                                                                                    | <u>14,869</u>               | <u>\$ 10,448</u> | <u>\$ 42,217</u>                      | <u>\$ 225,178</u>            | <u>\$ 3,105</u>                                                  | <u>\$ 280,948</u> |
| Balance December 31, 2015                                                                                     | 14,919                      | \$ 10,616        | \$ 44,180                             | \$ 231,091                   | \$ 632                                                           | \$ 286,519        |
| Net income                                                                                                    | —                           | —                | —                                     | 30,411                       | —                                                                | 30,411            |
| Other comprehensive income, net of tax                                                                        | —                           | —                | —                                     | —                            | 3,809                                                            | 3,809             |
| Stock compensation expense                                                                                    | —                           | —                | 1,646                                 | —                            | —                                                                | 1,646             |
| Stock issued for share-based awards, net of<br>withholdings to satisfy employee tax<br>obligations upon award | 159                         | 527              | 3,404                                 | (2,903)                      | —                                                                | 1,028             |
| 3 for 2 stock split                                                                                           | 7,494                       | 24,956           | (24,956)                              | —                            | —                                                                | —                 |
| Cash dividends, \$0.53 per share                                                                              | —                           | —                | —                                     | (11,843)                     | —                                                                | (11,843)          |
| Shares cancelled                                                                                              | (9)                         | (31)             | (224)                                 | 255                          | —                                                                | —                 |
| Balance September 30, 2016                                                                                    | <u>22,563</u>               | <u>\$ 36,068</u> | <u>\$ 24,050</u>                      | <u>\$ 247,011</u>            | <u>\$ 4,441</u>                                                  | <u>\$ 311,570</u> |

See accompanying notes to unaudited consolidated financial statements.

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**  
Consolidated Statements of Cash Flows (Unaudited)  
For the nine months ended September 30, 2016 and 2015  
(In thousands)

|                                                                                            | 2016      | 2015      |
|--------------------------------------------------------------------------------------------|-----------|-----------|
| <b>Operating activities:</b>                                                               |           |           |
| Net income                                                                                 | \$ 30,411 | \$ 27,541 |
| Adjustments to reconcile net income to net cash provided by operating activities:          |           |           |
| Provision for loan losses                                                                  | 2,500     | —         |
| Depreciation, amortization and accretion, net                                              | 8,016     | 5,088     |
| Deferred income tax expense (benefit)                                                      | (320)     | 1,326     |
| Gain on sales of mortgage loans held for sale                                              | (1,825)   | (1,611)   |
| Origination of mortgage loans held for sale                                                | (91,195)  | (90,997)  |
| Proceeds from sale of mortgage loans held for sale                                         | 93,861    | 90,816    |
| Bank owned life insurance income                                                           | (657)     | (670)     |
| Loss on the disposal of premises and equipment                                             | 163       | 3         |
| Loss (gain) on the sale of other real estate                                               | (382)     | 153       |
| Stock compensation expense                                                                 | 1,646     | 1,561     |
| Excess tax benefits from share-based compensation arrangements                             | (963)     | (366)     |
| Increase in accrued interest receivable and other assets                                   | (6,145)   | (1,049)   |
| Increase in accrued interest payable and other liabilities                                 | 14,253    | 2,509     |
| Net cash provided by operating activities                                                  | 49,363    | 34,304    |
| <b>Investing activities:</b>                                                               |           |           |
| Purchases of securities available for sale                                                 | (327,711) | (203,465) |
| Proceeds from sale of securities available for sale                                        | —         | 5,934     |
| Proceeds from maturities of securities available for sale                                  | 355,943   | 206,734   |
| Net increase in loans                                                                      | (191,793) | (90,224)  |
| Purchases of premises and equipment                                                        | (5,906)   | (3,136)   |
| Proceeds from disposal of premises and equipment                                           | 53        | —         |
| Proceeds from sale of foreclosed assets                                                    | 1,403     | 2,332     |
| Net cash used in investing activities                                                      | (168,011) | (81,825)  |
| <b>Financing activities:</b>                                                               |           |           |
| Net increase in deposits                                                                   | 18,895    | 17,951    |
| Net increase in securities sold under agreements to repurchase and federal funds purchased | 56,699    | 12,709    |
| Proceeds from Federal Home Loan Bank advances                                              | 199,000   | 78,200    |
| Repayments of Federal Home Loan Bank advances                                              | (191,102) | (71,333)  |
| Issuance of common stock for options and performance stock units                           | 1,599     | 1,994     |
| Excess tax benefits from share-based compensation arrangements                             | 963       | 366       |
| Common stock repurchases                                                                   | (1,534)   | (910)     |
| Cash dividends paid                                                                        | (11,812)  | (10,503)  |
| Net cash provided by financing activities                                                  | 72,708    | 28,474    |
| Net decrease in cash and cash equivalents                                                  | (45,940)  | (19,047)  |
| Cash and cash equivalents at beginning of period                                           | 103,833   | 74,241    |
| Cash and cash equivalents at end of period                                                 | \$ 57,893 | \$ 55,194 |
| <b>Supplemental cash flow information:</b>                                                 |           |           |
| Income tax payments                                                                        | \$ 9,190  | \$ 10,177 |
| Cash paid for interest                                                                     | 3,636     | 3,640     |
| <b>Supplemental non-cash activity:</b>                                                     |           |           |
| Transfers from loans to other real estate owned                                            | \$ 1,522  | \$ 1,043  |

See accompanying notes to unaudited consolidated financial statements.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

### Notes to Consolidated Financial Statements (Unaudited)

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

The accompanying unaudited consolidated financial statements have been prepared in accordance with 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, 2015 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, 2016 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. The provision reflects an allowance methodology that is driven by risk ratings, historical losses, and qualitative factors. Assumptions include many factors such as changes in borrowers' financial condition which can occur 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.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Bancorp's allowance calculation includes allocations to loan portfolio segments at September 30, 2016 for qualitative factors including, among other factors, economic and business conditions in each of our primary markets, the quality and experience of lending staff and management, exceptions to lending policies, levels of and trends in past due loans and loan classifications, concentrations of credit such as collateral type, trends in portfolio growth, dependency upon the value of underlying collateral for collateral-dependent loans, effect of other external factors such as the national economic and business trends, quality and depth of the loan review function and management's judgement of current trends and potential risks. Bancorp uses 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 follows:

| (in thousands)                                      | Amortized  | Unrealized |          |            |
|-----------------------------------------------------|------------|------------|----------|------------|
| September 30, 2016                                  | cost       | Gains      | Losses   | Fair value |
| Government sponsored enterprise obligations         | \$ 316,763 | \$ 4,080   | \$ 114   | \$ 320,729 |
| Mortgage-backed securities - government agencies    | 158,478    | 2,767      | 168      | 161,077    |
| Obligations of states and political subdivisions    | 57,979     | 1,229      | 41       | 59,167     |
| Corporate equity securities                         | 653        | 55         | -        | 708        |
| Total securities available for sale                 | \$ 533,873 | \$ 8,131   | \$ 323   | \$ 541,681 |
| December 31, 2015                                   |            |            |          |            |
| U.S. Treasury and other U.S. Government obligations | \$ 79,999  | \$ 1       | \$ -     | \$ 80,000  |
| Government sponsored enterprise obligations         | 251,190    | 1,468      | 765      | 251,893    |
| Mortgage-backed securities - government agencies    | 170,139    | 1,143      | 1,654    | 169,628    |
| Obligations of states and political subdivisions    | 62,410     | 1,342      | 50       | 63,702     |
| Corporate equity securities                         | 653        | -          | -        | 653        |
| Total securities available for sale                 | \$ 564,391 | \$ 3,954   | \$ 2,469 | \$ 565,876 |

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, 2016 or December 31, 2015.

No securities were sold in 2016. In 2015, Bancorp sold securities with total fair market value of \$5.9 million, generating no gain or loss. These securities consisted of mortgage-backed securities with small remaining balances 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.

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

A summary of the available-for-sale investment securities by contractual maturity groupings as of September 30, 2016 is shown below.

(in thousands)

| <b>Securities available-for-sale</b>             | <b>Amortized cost</b> | <b>Fair value</b> |
|--------------------------------------------------|-----------------------|-------------------|
| Due within 1 year                                | \$ 135,930            | \$ 136,043        |
| Due after 1 but within 5 years                   | 108,969               | 110,468           |
| Due after 5 but within 10 years                  | 19,293                | 19,633            |
| Due after 10 years                               | 110,550               | 113,752           |
| Mortgage-backed securities – government agencies | 158,478               | 161,077           |
| Corporate equity securities                      | 653                   | 708               |
| <b>Total securities available-for-sale</b>       | <b>\$ 533,873</b>     | <b>\$ 541,681</b> |

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

Securities with a carrying value of approximately \$323.3 million at September 30, 2016 and \$380.7 million at December 31, 2015 were pledged to secure accounts of commercial depositors in cash management accounts, public deposits, and deposits for certain wealth management and trust accounts.

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Securities with unrealized losses at September 30, 2016 and December 31, 2015, not recognized in the statements of income are as follows:

(in thousands)

|                                                  | Less than 12 months |                   | 12 months or more |                   | Total             |                   |
|--------------------------------------------------|---------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
|                                                  | Fair value          | Unrealized losses | Fair value        | Unrealized losses | Fair value        | Unrealized losses |
| <b>September 30, 2016</b>                        |                     |                   |                   |                   |                   |                   |
| Government sponsored enterprise obligations      | \$ 135,908          | \$ 78             | \$ 3,834          | \$ 36             | \$ 139,742        | \$ 114            |
| Mortgage-backed securities - government agencies | 14,945              | 36                | 10,729            | 132               | 25,674            | 168               |
| Obligations of states and political subdivisions | 8,717               | 30                | 1,489             | 11                | 10,206            | 41                |
| <b>Total temporarily impaired securities</b>     | <b>\$ 159,570</b>   | <b>\$ 144</b>     | <b>\$ 16,052</b>  | <b>\$ 179</b>     | <b>\$ 175,622</b> | <b>\$ 323</b>     |
| <b>December 31, 2015</b>                         |                     |                   |                   |                   |                   |                   |
| Government sponsored enterprise obligations      | \$ 102,098          | \$ 500            | \$ 8,469          | \$ 265            | \$ 110,567        | \$ 765            |
| Mortgage-backed securities - government agencies | 49,774              | 662               | 29,936            | 992               | 79,710            | 1,654             |
| Obligations of states and political subdivisions | 13,225              | 31                | 1,955             | 19                | 15,180            | 50                |
| <b>Total temporarily impaired securities</b>     | <b>\$ 165,097</b>   | <b>\$ 1,193</b>   | <b>\$ 40,360</b>  | <b>\$ 1,276</b>   | <b>\$ 205,457</b> | <b>\$ 2,469</b>   |

Applicable dates for determining when securities are in an unrealized loss position are September 30, 2016 and December 31, 2015. 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 42 and 70 separate investment positions as of September 30, 2016 and December 31, 2015, 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, 2016.

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.

**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, 2016 | December 31, 2015 |
|----------------------------------------------------------|--------------------|-------------------|
| Commercial and industrial                                | \$ 708,508         | \$ 644,398        |
| Construction and development, excluding undeveloped land | 171,994            | 134,482           |
| Undeveloped land                                         | 19,993             | 21,185            |
| Real estate mortgage:                                    |                    |                   |
| Commercial investment                                    | 510,128            | 436,989           |
| Owner occupied commercial                                | 412,733            | 420,666           |
| 1-4 family residential                                   | 245,229            | 226,575           |
| Home equity - first lien                                 | 54,837             | 50,115            |
| Home equity - junior lien                                | 65,605             | 63,066            |
| Subtotal: Real estate mortgage                           | 1,288,532          | 1,197,411         |
| Consumer                                                 | 33,679             | 35,531            |
| Total loans                                              | \$ 2,222,706       | \$ 2,033,007      |

**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, 2016 and December 31, 2015.

(in thousands)

|                                                               | Type of loan                    |                                                                     |                     |                         |                  |                     |
|---------------------------------------------------------------|---------------------------------|---------------------------------------------------------------------|---------------------|-------------------------|------------------|---------------------|
|                                                               | Commercial<br>and<br>industrial | Construction<br>and development<br>excluding<br>undeveloped<br>land | Undeveloped<br>land | Real estate<br>mortgage | Consumer         | Total               |
| <b>September 30, 2016</b>                                     |                                 |                                                                     |                     |                         |                  |                     |
| <b>Loans</b>                                                  | <u>\$ 708,508</u>               | <u>\$ 171,994</u>                                                   | <u>\$ 19,993</u>    | <u>\$ 1,288,532</u>     | <u>\$ 33,679</u> | <u>\$ 2,222,706</u> |
| Loans collectively evaluated for impairment                   | <u>\$ 705,335</u>               | <u>\$ 171,084</u>                                                   | <u>\$ 19,338</u>    | <u>\$ 1,284,798</u>     | <u>\$ 33,592</u> | <u>\$ 2,214,147</u> |
| Loans individually evaluated for impairment                   | <u>\$ 3,115</u>                 | <u>\$ 910</u>                                                       | <u>\$ 655</u>       | <u>\$ 3,121</u>         | <u>\$ 87</u>     | <u>\$ 7,888</u>     |
| Loans acquired with deteriorated credit quality               | <u>\$ 58</u>                    | <u>\$ -</u>                                                         | <u>\$ -</u>         | <u>\$ 613</u>           | <u>\$ -</u>      | <u>\$ 671</u>       |
|                                                               |                                 |                                                                     |                     |                         |                  |                     |
|                                                               | Commercial<br>and<br>industrial | Construction<br>and development<br>excluding<br>undeveloped<br>land | Undeveloped<br>land | Real estate<br>mortgage | Consumer         | Total               |
| <b>Allowance for loan losses</b>                              |                                 |                                                                     |                     |                         |                  |                     |
| At December 31, 2015                                          | \$ 8,645                        | \$ 1,760                                                            | \$ 814              | \$ 10,875               | \$ 347           | \$ 22,441           |
| Provision (credit)                                            | 2,415                           | 229                                                                 | (128)               | (131)                   | 115              | 2,500               |
| Charge-offs                                                   | (627)                           | -                                                                   | -                   | (426)                   | (419)            | (1,472)             |
| Recoveries                                                    | 252                             | 21                                                                  | -                   | 318                     | 309              | 900                 |
| At September 30, 2016                                         | <u>\$ 10,685</u>                | <u>\$ 2,010</u>                                                     | <u>\$ 686</u>       | <u>\$ 10,636</u>        | <u>\$ 352</u>    | <u>\$ 24,369</u>    |
| Allowance for loans collectively evaluated for impairment     | <u>\$ 9,296</u>                 | <u>\$ 1,865</u>                                                     | <u>\$ 652</u>       | <u>\$ 10,483</u>        | <u>\$ 291</u>    | <u>\$ 22,587</u>    |
| Allowance for loans individually evaluated for impairment     | <u>\$ 1,389</u>                 | <u>\$ 145</u>                                                       | <u>\$ 34</u>        | <u>\$ 153</u>           | <u>\$ 61</u>     | <u>\$ 1,782</u>     |
| Allowance for loans acquired with deteriorated credit quality | <u>\$ -</u>                     | <u>\$ -</u>                                                         | <u>\$ -</u>         | <u>\$ -</u>             | <u>\$ -</u>      | <u>\$ -</u>         |

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

(in thousands)

|                                                               | Type of loan              |                                                         |                  |                      |                  |                     |
|---------------------------------------------------------------|---------------------------|---------------------------------------------------------|------------------|----------------------|------------------|---------------------|
|                                                               | Commercial and industrial | Construction and development excluding undeveloped land | Undeveloped land | Real estate mortgage | Consumer         | Total               |
| <b>December 31, 2015</b>                                      |                           |                                                         |                  |                      |                  |                     |
| <b>Loans</b>                                                  | <u>\$ 644,398</u>         | <u>\$ 134,482</u>                                       | <u>\$ 21,185</u> | <u>\$ 1,197,411</u>  | <u>\$ 35,531</u> | <u>\$ 2,033,007</u> |
| Loans collectively evaluated for impairment                   | <u>\$ 639,760</u>         | <u>\$ 134,160</u>                                       | <u>\$ 21,185</u> | <u>\$ 1,192,864</u>  | <u>\$ 35,463</u> | <u>\$ 2,023,432</u> |
| Loans individually evaluated for impairment                   | <u>\$ 4,635</u>           | <u>\$ -</u>                                             | <u>\$ -</u>      | <u>\$ 4,050</u>      | <u>\$ 68</u>     | <u>\$ 8,753</u>     |
| Loans acquired with deteriorated credit quality               | <u>\$ 3</u>               | <u>\$ 322</u>                                           | <u>\$ -</u>      | <u>\$ 497</u>        | <u>\$ -</u>      | <u>\$ 822</u>       |
|                                                               |                           |                                                         |                  |                      |                  |                     |
|                                                               | Commercial and industrial | Construction and development excluding undeveloped land | Undeveloped land | Real estate mortgage | Consumer         | Total               |
| <b>Allowance for loan losses</b>                              |                           |                                                         |                  |                      |                  |                     |
| At December 31, 2014                                          | \$ 11,819                 | \$ 721                                                  | \$ 1,545         | \$ 10,541            | \$ 294           | \$ 24,920           |
| Provision (credit)                                            | 793                       | 1,065                                                   | (2,131)          | 872                  | 151              | 750                 |
| Charge-offs                                                   | (4,065)                   | (26)                                                    | -                | (693)                | (597)            | (5,381)             |
| Recoveries                                                    | 98                        | -                                                       | 1,400            | 155                  | 499              | 2,152               |
| At December 31, 2015                                          | <u>\$ 8,645</u>           | <u>\$ 1,760</u>                                         | <u>\$ 814</u>    | <u>\$ 10,875</u>     | <u>\$ 347</u>    | <u>\$ 22,441</u>    |
| Allowance for loans collectively evaluated for impairment     | <u>\$ 8,377</u>           | <u>\$ 1,760</u>                                         | <u>\$ 814</u>    | <u>\$ 10,667</u>     | <u>\$ 279</u>    | <u>\$ 21,897</u>    |
| Allowance for loans individually evaluated for impairment     | <u>\$ 268</u>             | <u>\$ -</u>                                             | <u>\$ -</u>      | <u>\$ 208</u>        | <u>\$ 68</u>     | <u>\$ 544</u>       |
| Allowance for loans acquired with deteriorated credit quality | <u>\$ -</u>               | <u>\$ -</u>                                             | <u>\$ -</u>      | <u>\$ -</u>          | <u>\$ -</u>      | <u>\$ -</u>         |

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 decline in the strength of the business or a weakened economy and resultant decreased consumer and/or business spending may 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.

# **STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

- Undeveloped land: Loans in this category are secured by land acquired for development by the borrower, but for which no development has yet taken place. Credit risk is primarily dependent upon the financial strength of the borrower, and can be affected by market conditions and time to 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. For owner occupied residential and commercial real estate, repayment is dependent on financial strength of the borrower. For income-producing investment properties, repayment is dependent on financial strength of tenants in addition to the borrower. Underlying properties are generally located in Bancorp's primary market area. Cash flows of income producing investment properties may be adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, could 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, adequacy 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 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, 2016 and December 31, 2015. Changes in the fair value adjustment for acquired impaired loans are shown in the following table:

| (in thousands)                                      | <b>Accretable<br/>discount</b> | <b>Non-<br/>accretable<br/>discount</b> |
|-----------------------------------------------------|--------------------------------|-----------------------------------------|
| Balance at December 31, 2014                        | \$ 62                          | \$ 266                                  |
| Accretion                                           | (59)                           | (77)                                    |
| Reclassifications from (to) non-accretable discount | -                              | -                                       |
| Disposals                                           | -                              | -                                       |
| Balance at December 31, 2015                        | <u>\$ 3</u>                    | <u>\$ 189</u>                           |
| Accretion                                           | (3)                            | (41)                                    |
| Reclassifications from (to) non-accretable discount | -                              | -                                       |
| Disposals                                           | -                              | -                                       |
| Balance at September 30, 2016                       | <u>\$ -</u>                    | <u>\$ 148</u>                           |

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

The following tables present loans individually evaluated for impairment as of September 30, 2016 and December 31, 2015.

(in thousands)

|                                                          | <b>Recorded<br/>investment</b> | <b>Unpaid<br/>principal<br/>balance</b> | <b>Related<br/>allowance</b> | <b>Average<br/>recorded<br/>investment</b> |
|----------------------------------------------------------|--------------------------------|-----------------------------------------|------------------------------|--------------------------------------------|
| <b>September 30, 2016</b>                                |                                |                                         |                              |                                            |
| Loans with no related allowance recorded:                |                                |                                         |                              |                                            |
| Commercial and industrial                                | \$ 999                         | \$ 1,440                                | \$ -                         | \$ 2,354                                   |
| Construction and development, excluding undeveloped land | -                              | -                                       | -                            | -                                          |
| Undeveloped land                                         | 149                            | 149                                     | -                            | 37                                         |
| Real estate mortgage                                     |                                |                                         |                              |                                            |
| Commercial investment                                    | 94                             | 94                                      | -                            | 214                                        |
| Owner occupied commercial                                | 1,060                          | 1,497                                   | -                            | 1,434                                      |
| 1-4 family residential                                   | 920                            | 920                                     | -                            | 980                                        |
| Home equity - first lien                                 | -                              | -                                       | -                            | 3                                          |
| Home equity - junior lien                                | 559                            | 559                                     | -                            | 299                                        |
| Subtotal: Real estate mortgage                           | 2,633                          | 3,070                                   | -                            | 2,930                                      |
| Consumer                                                 | 26                             | 26                                      | -                            | 22                                         |
| Subtotal                                                 | <u>\$ 3,807</u>                | <u>\$ 4,685</u>                         | <u>\$ -</u>                  | <u>\$ 5,343</u>                            |
| Loans with an allowance recorded:                        |                                |                                         |                              |                                            |
| Commercial and industrial                                | \$ 2,116                       | \$ 2,590                                | \$ 1,389                     | \$ 1,433                                   |
| Construction and development, excluding undeveloped land | 910                            | 910                                     | 145                          | 228                                        |
| Undeveloped land                                         | 506                            | 506                                     | 34                           | 127                                        |
| Real estate mortgage                                     |                                |                                         |                              |                                            |
| Commercial investment                                    | -                              | -                                       | -                            | -                                          |
| Owner occupied commercial                                | 488                            | 488                                     | 153                          | 693                                        |
| 1-4 family residential                                   | -                              | -                                       | -                            | -                                          |
| Home equity - first lien                                 | -                              | -                                       | -                            | -                                          |
| Home equity - junior lien                                | -                              | -                                       | -                            | -                                          |
| Subtotal: Real estate mortgage                           | 488                            | 488                                     | 153                          | 693                                        |
| Consumer                                                 | 61                             | 61                                      | 61                           | 65                                         |
| Subtotal                                                 | <u>\$ 4,081</u>                | <u>\$ 4,555</u>                         | <u>\$ 1,782</u>              | <u>\$ 2,546</u>                            |
| Total:                                                   |                                |                                         |                              |                                            |
| Commercial and industrial                                | \$ 3,115                       | \$ 4,030                                | \$ 1,389                     | \$ 3,787                                   |
| Construction and development, excluding undeveloped land | 910                            | 910                                     | 145                          | 228                                        |
| Undeveloped land                                         | 655                            | 655                                     | 34                           | 164                                        |
| Real estate mortgage                                     |                                |                                         |                              |                                            |
| Commercial investment                                    | 94                             | 94                                      | -                            | 214                                        |
| Owner occupied commercial                                | 1,548                          | 1,985                                   | 153                          | 2,127                                      |
| 1-4 family residential                                   | 920                            | 920                                     | -                            | 980                                        |
| Home equity - first lien                                 | -                              | -                                       | -                            | 3                                          |
| Home equity - junior lien                                | 559                            | 559                                     | -                            | 299                                        |
| Subtotal: Real estate mortgage                           | 3,121                          | 3,558                                   | 153                          | 3,623                                      |
| Consumer                                                 | 87                             | 87                                      | 61                           | 87                                         |
| Total                                                    | <u>\$ 7,888</u>                | <u>\$ 9,240</u>                         | <u>\$ 1,782</u>              | <u>\$ 7,889</u>                            |

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

(in thousands)

| <b>December 31, 2015</b>                                 | <b>Recorded<br/>investment</b> | <b>Unpaid<br/>principal<br/>balance</b> | <b>Related<br/>allowance</b> | <b>Average<br/>recorded<br/>investment</b> |
|----------------------------------------------------------|--------------------------------|-----------------------------------------|------------------------------|--------------------------------------------|
| <b>Loans with no related allowance recorded:</b>         |                                |                                         |                              |                                            |
| Commercial and industrial                                | \$ 3,119                       | \$ 3,859                                | \$ -                         | \$ 1,414                                   |
| Construction and development, excluding undeveloped land | -                              | 151                                     | -                            | 21                                         |
| Undeveloped land                                         | -                              | -                                       | -                            | -                                          |
| Real estate mortgage                                     |                                |                                         |                              |                                            |
| Commercial investment                                    | 278                            | 278                                     | -                            | 178                                        |
| Owner occupied commercial                                | 1,743                          | 2,713                                   | -                            | 1,622                                      |
| 1-4 family residential                                   | 906                            | 906                                     | -                            | 661                                        |
| Home equity - first lien                                 | 13                             | 13                                      | -                            | 37                                         |
| Home equity - junior lien                                | 92                             | 92                                      | -                            | 69                                         |
| Subtotal: Real estate mortgage                           | 3,032                          | 4,002                                   | -                            | 2,567                                      |
| Consumer                                                 | -                              | -                                       | -                            | 3                                          |
| Subtotal                                                 | <u>\$ 6,151</u>                | <u>\$ 8,012</u>                         | <u>\$ -</u>                  | <u>\$ 4,005</u>                            |
| <b>Loans with an allowance recorded:</b>                 |                                |                                         |                              |                                            |
| Commercial and industrial                                | \$ 1,516                       | \$ 3,087                                | \$ 268                       | \$ 4,612                                   |
| Construction and development, excluding undeveloped land | -                              | -                                       | -                            | 368                                        |
| Undeveloped land                                         | -                              | -                                       | -                            | -                                          |
| Real estate mortgage                                     |                                |                                         |                              |                                            |
| Commercial investment                                    | -                              | -                                       | -                            | 92                                         |
| Owner occupied commercial                                | 1,018                          | 1,018                                   | 208                          | 1,266                                      |
| 1-4 family residential                                   | -                              | -                                       | -                            | 188                                        |
| Home equity - first lien                                 | -                              | -                                       | -                            | -                                          |
| Home equity - junior lien                                | -                              | -                                       | -                            | -                                          |
| Subtotal: Real estate mortgage                           | 1,018                          | 1,018                                   | 208                          | 1,546                                      |
| Consumer                                                 | 68                             | 68                                      | 68                           | 72                                         |
| Subtotal                                                 | <u>\$ 2,602</u>                | <u>\$ 4,173</u>                         | <u>\$ 544</u>                | <u>\$ 6,598</u>                            |
| <b>Total:</b>                                            |                                |                                         |                              |                                            |
| Commercial and industrial                                | \$ 4,635                       | \$ 6,946                                | \$ 268                       | \$ 6,026                                   |
| Construction and development, excluding undeveloped land | -                              | 151                                     | -                            | 389                                        |
| Undeveloped land                                         | -                              | -                                       | -                            | -                                          |
| Real estate mortgage                                     |                                |                                         |                              |                                            |
| Commercial investment                                    | 278                            | 278                                     | -                            | 270                                        |
| Owner occupied commercial                                | 2,761                          | 3,731                                   | 208                          | 2,888                                      |
| 1-4 family residential                                   | 906                            | 906                                     | -                            | 849                                        |
| Home equity - first lien                                 | 13                             | 13                                      | -                            | 37                                         |
| Home equity - junior lien                                | 92                             | 92                                      | -                            | 69                                         |
| Subtotal: Real estate mortgage                           | 4,050                          | 5,020                                   | 208                          | 4,113                                      |
| Consumer                                                 | 68                             | 68                                      | 68                           | 75                                         |
| Total                                                    | <u>\$ 8,753</u>                | <u>\$ 12,185</u>                        | <u>\$ 544</u>                | <u>\$ 10,603</u>                           |

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.

# **STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

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. Bancorp had loans past due more than 90 days and still accruing interest totaling \$80 thousand at September 30, 2016, compared with \$176 thousand at December 31, 2015.

The following table presents the recorded investment in non-accrual loans as of September 30, 2016 and December 31, 2015.

| (in thousands)                                           | <u>September 30, 2016</u> | <u>December 31, 2015</u> |
|----------------------------------------------------------|---------------------------|--------------------------|
| Commercial and industrial                                | \$ 2,177                  | \$ 3,643                 |
| Construction and development, excluding undeveloped land | 910                       | -                        |
| Undeveloped land                                         | 655                       | -                        |
| Real estate mortgage                                     |                           |                          |
| Commercial investment                                    | 94                        | 278                      |
| Owner occupied commercial                                | 1,548                     | 2,761                    |
| 1-4 family residential                                   | 920                       | 906                      |
| Home equity - first lien                                 | -                         | 13                       |
| Home equity - junior lien                                | 559                       | 92                       |
| Subtotal: Real estate mortgage                           | <u>3,121</u>              | <u>4,050</u>             |
| Consumer                                                 | 26                        | -                        |
| Total                                                    | <u>\$ 6,889</u>           | <u>\$ 7,693</u>          |

At September 30, 2016 and December 31, 2015, Bancorp had \$999 thousand and \$1.1 million of accruing loans classified as TDR, respectively. Bancorp did not modify and classify any additional loans as TDR during the three or nine month periods ended September 30, 2016 or 2015.

No loans classified and reported as troubled debt restructured within the twelve months prior to September 30, 2016 defaulted during the three-month or nine-month periods ended September 30, 2016. Likewise, no loans classified and reported as troubled debt restructured within the twelve months prior to September 30, 2015 defaulted during the three-month or nine-month periods ended September 30, 2015. 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, 2016, had a total allowance allocation of \$314 thousand, compared with \$177 thousand at December 31, 2015.

At September 30, 2016 and December 31, 2015, Bancorp did not have any outstanding commitments to lend additional funds to borrowers whose loans have been modified as TDR.

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

The following table presents the aging of the recorded investment in loans as of September 30, 2016 and December 31, 2015.

(in thousands)

|                                                             |                                |                                | 90 or more<br>days past<br>due<br>(includes)<br>non-<br>accrual) | Total<br>past due | Current             | Total<br>loans      | Recorded<br>investment<br>> 90 days<br>and<br>accruing |
|-------------------------------------------------------------|--------------------------------|--------------------------------|------------------------------------------------------------------|-------------------|---------------------|---------------------|--------------------------------------------------------|
| <b>September 30, 2016</b>                                   | <b>30-59 days<br/>past due</b> | <b>60-89 days<br/>past due</b> |                                                                  |                   |                     |                     |                                                        |
| Commercial and industrial                                   | \$ 40                          | \$ 140                         | \$ 2,177                                                         | \$ 2,357          | \$ 706,151          | \$ 708,508          | \$ -                                                   |
| Construction and development, excluding<br>undeveloped land | 235                            | 214                            | 910                                                              | 1,359             | 170,635             | 171,994             | -                                                      |
| Undeveloped land                                            | -                              | -                              | 654                                                              | 654               | 19,339              | 19,993              | -                                                      |
| Real estate mortgage                                        |                                |                                |                                                                  |                   |                     |                     |                                                        |
| Commercial investment                                       | 380                            | 171                            | 94                                                               | 645               | 509,483             | 510,128             | -                                                      |
| Owner occupied commercial                                   | 1,220                          | 331                            | 1,548                                                            | 3,099             | 409,634             | 412,733             | -                                                      |
| 1-4 family residential                                      | 1,292                          | 966                            | 954                                                              | 3,212             | 242,017             | 245,229             | 34                                                     |
| Home equity - first lien                                    | -                              | -                              | 46                                                               | 46                | 54,791              | 54,837              | 46                                                     |
| Home equity - junior lien                                   | 641                            | 31                             | 560                                                              | 1,232             | 64,373              | 65,605              | -                                                      |
| Subtotal: Real estate mortgage                              | 3,533                          | 1,499                          | 3,202                                                            | 8,234             | 1,280,298           | 1,288,532           | 80                                                     |
| Consumer                                                    | 16                             | 1                              | 26                                                               | 43                | 33,636              | 33,679              | -                                                      |
| Total                                                       | <u>\$ 3,824</u>                | <u>\$ 1,854</u>                | <u>\$ 6,969</u>                                                  | <u>\$ 12,647</u>  | <u>\$ 2,210,059</u> | <u>\$ 2,222,706</u> | <u>\$ 80</u>                                           |
| <b>December 31, 2015</b>                                    |                                |                                |                                                                  |                   |                     |                     |                                                        |
| Commercial and industrial                                   | \$ 238                         | \$ 327                         | \$ 3,643                                                         | \$ 4,208          | \$ 640,190          | \$ 644,398          | \$ -                                                   |
| Construction and development, excluding<br>undeveloped land | -                              | -                              | -                                                                | -                 | 134,482             | 134,482             | -                                                      |
| Undeveloped land                                            | -                              | -                              | -                                                                | -                 | 21,185              | 21,185              | -                                                      |
| Real estate mortgage                                        |                                |                                |                                                                  |                   |                     |                     |                                                        |
| Commercial investment                                       | 290                            | 140                            | 278                                                              | 708               | 436,281             | 436,989             | -                                                      |
| Owner occupied commercial                                   | -                              | -                              | 2,761                                                            | 2,761             | 417,905             | 420,666             | -                                                      |
| 1-4 family residential                                      | 1,147                          | 94                             | 1,082                                                            | 2,323             | 224,252             | 226,575             | 176                                                    |
| Home equity - first lien                                    | 35                             | 51                             | 13                                                               | 99                | 50,016              | 50,115              | -                                                      |
| Home equity - junior lien                                   | 285                            | 173                            | 92                                                               | 550               | 62,516              | 63,066              | -                                                      |
| Subtotal: Real estate mortgage                              | 1,757                          | 458                            | 4,226                                                            | 6,441             | 1,190,970           | 1,197,411           | 176                                                    |
| Consumer                                                    | 343                            | 8                              | -                                                                | 351               | 35,180              | 35,531              | -                                                      |
| Total                                                       | <u>\$ 2,338</u>                | <u>\$ 793</u>                  | <u>\$ 7,869</u>                                                  | <u>\$ 11,000</u>  | <u>\$ 2,022,007</u> | <u>\$ 2,033,007</u> | <u>\$ 176</u>                                          |

## **STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

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

- Other assets especially mentioned (“OAEM”): Loans classified as OAEM have potential weaknesses that deserve management's close attention. These potential weaknesses may result in deterioration of repayment prospects for the loan or of Bancorp's credit position at some future date.
- Substandard: Loans classified as substandard are inadequately protected by the paying capacity of the obligor or of collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize repayment of the debt. Default is a distinct possibility if 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. Loans are placed on non-accrual status when prospects for recovering both principal and accrued interest are considered doubtful or when a default of principal or interest has existed for 90 days or more.
- 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.

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

As of September 30, 2016 and December 31, 2015, the internally assigned risk grades of loans by category were as follows:

(in thousands)

| <b>September 30, 2016</b>                                   | <b>Pass</b>         | <b>OAEM</b>      | <b>Substandard</b> | <b>Substandard<br/>non-<br/>performing</b> | <b>Doubtful</b> | <b>Total<br/>loans</b> |
|-------------------------------------------------------------|---------------------|------------------|--------------------|--------------------------------------------|-----------------|------------------------|
| Commercial and industrial                                   | \$ 684,445          | \$ 15,290        | \$ 5,658           | \$ 3,115                                   | \$ -            | \$ 708,508             |
| Construction and development,<br>excluding undeveloped land | 170,755             | -                | 329                | 910                                        | -               | 171,994                |
| Undeveloped land                                            | 19,338              | -                | 1                  | 654                                        | -               | 19,993                 |
| Real estate mortgage                                        |                     |                  |                    |                                            |                 |                        |
| Commercial investment                                       | 508,150             | 1,884            | -                  | 94                                         | -               | 510,128                |
| Owner occupied commercial                                   | 401,383             | 8,294            | 1,508              | 1,548                                      | -               | 412,733                |
| 1-4 family residential                                      | 244,275             | -                | -                  | 954                                        | -               | 245,229                |
| Home equity - first lien                                    | 54,791              | -                | -                  | 46                                         | -               | 54,837                 |
| Home equity - junior lien                                   | 65,045              | -                | -                  | 560                                        | -               | 65,605                 |
| Subtotal: Real estate mortgage                              | 1,273,644           | 10,178           | 1,508              | 3,202                                      | -               | 1,288,532              |
| Consumer                                                    | 33,592              | -                | -                  | 87                                         | -               | 33,679                 |
| Total                                                       | <u>\$ 2,181,774</u> | <u>\$ 25,468</u> | <u>\$ 7,496</u>    | <u>\$ 7,968</u>                            | <u>\$ -</u>     | <u>\$ 2,222,706</u>    |
| <b>December 31, 2015</b>                                    |                     |                  |                    |                                            |                 |                        |
| Commercial and industrial                                   | \$ 612,853          | \$ 19,672        | \$ 7,238           | \$ 4,635                                   | \$ -            | \$ 644,398             |
| Construction and development,<br>excluding undeveloped land | 133,342             | 773              | 367                | -                                          | -               | 134,482                |
| Undeveloped land                                            | 20,513              | 517              | 155                | -                                          | -               | 21,185                 |
| Real estate mortgage                                        |                     |                  |                    |                                            |                 |                        |
| Commercial investment                                       | 434,528             | 2,183            | -                  | 278                                        | -               | 436,989                |
| Owner occupied commercial                                   | 397,357             | 17,135           | 3,413              | 2,761                                      | -               | 420,666                |
| 1-4 family residential                                      | 224,645             | 848              | -                  | 1,082                                      | -               | 226,575                |
| Home equity - first lien                                    | 50,102              | -                | -                  | 13                                         | -               | 50,115                 |
| Home equity - junior lien                                   | 62,924              | 50               | -                  | 92                                         | -               | 63,066                 |
| Subtotal: Real estate mortgage                              | 1,169,556           | 20,216           | 3,413              | 4,226                                      | -               | 1,197,411              |
| Consumer                                                    | 35,463              | -                | -                  | 68                                         | -               | 35,531                 |
| Total                                                       | <u>\$ 1,971,727</u> | <u>\$ 41,178</u> | <u>\$ 11,173</u>   | <u>\$ 8,929</u>                            | <u>\$ -</u>     | <u>\$ 2,033,007</u>    |

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

### (4) Deposits

The composition of interest bearing deposits outstanding at September 30, 2016 (unaudited) and December 31, 2015 are as follows:

| (In thousands)                  | September 30,<br>2016 | December 31,<br>2015 |
|---------------------------------|-----------------------|----------------------|
| Interest bearing demand         | \$ 665,360            | \$ 737,347           |
| Savings                         | 136,503               | 127,496              |
| Money market                    | 662,416               | 655,729              |
| Time deposits:                  |                       |                      |
| less than \$100,000             | 150,466               | 161,738              |
| \$100,000-\$250,000             | 61,366                | 66,636               |
| Greater than \$250,000          | 34,408                | 38,988               |
| Total time deposits             | 246,240               | 267,362              |
| Total interest bearing deposits | <u>\$ 1,710,519</u>   | <u>\$ 1,787,934</u>  |

Maturities of time deposits of \$100,000 or more outstanding at September 30, 2016 are summarized as follows:

| (In thousands)           | Amount           |
|--------------------------|------------------|
| 3 months or less         | \$ 20,746        |
| Over 3 through 6 months  | 13,345           |
| Over 6 through 12 months | 30,556           |
| Over 12 months           | 31,127           |
| Total                    | <u>\$ 95,774</u> |

### (5) 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 \$67.3 million and \$64.5 million at September 30, 2016 and December 31, 2015, respectively. Bancorp enters into sales of securities under agreement to repurchase at a specified future date. At September 30, 2016, 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.

### (6) Federal Home Loan Bank Advances

Bancorp had outstanding borrowings totaling of \$51.4 million and \$43.5 million at September 30, 2016 and December 31, 2015, respectively, via 14 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 \$21.4 million, principal and interest payments are due monthly based on an amortization schedule.

# **STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

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

(In thousands)

| Year  | September 30, 2016 |            | December 31, 2015 |            |
|-------|--------------------|------------|-------------------|------------|
|       | Advance            | Fixed Rate | Advance           | Fixed Rate |
| 2016  | \$ 30,000          | 0.55%      | \$ 30,000         | 0.55%      |
| 2020  | 1,802              | 2.23       | 1,838             | 2.23       |
| 2021  | 377                | 2.12       | 429               | 2.12       |
| 2024  | 2,713              | 2.36       | 2,865             | 2.36       |
| 2025  | 6,160              | 2.43       | 6,991             | 2.44       |
| 2026  | 9,000              | 1.99       | -                 | -          |
| 2028  | 1,314              | 1.48       | 1,345             | 1.48       |
| Total | \$ 51,366          | 1.22%      | \$ 43,468         | 1.09%      |

In addition to the fixed-rate advances listed above, Bancorp had a \$60 million cash management advance from the FHLB. This advance matured in the first week of October 2016 and was used to manage Bancorp's overall cash position. Due to the short nature of the advance, it was recorded on the consolidated balance sheet within Federal funds purchased and other short-term borrowings.

Advances from the FHLB are collateralized by certain commercial and residential real estate mortgage loans totaling \$651.1 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, 2016, the amount of available credit from the FHLB totaled \$366.5 million.

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

## (7) Other Comprehensive Income

The following table illustrates activity within the balances in accumulated other comprehensive income by component, and is shown for the nine months ended September 30, 2016 and 2015.

| (in thousands)                                            | Net unrealized<br>gains on<br>securities<br>available-for-<br>sale | Net unrealized<br>gains (losses)<br>on cash<br>flow hedges | Minimum<br>pension<br>liability<br>adjustment | Total           |
|-----------------------------------------------------------|--------------------------------------------------------------------|------------------------------------------------------------|-----------------------------------------------|-----------------|
| Balance at December 31, 2014                              | \$ 2,456                                                           | \$ 16                                                      | \$ (387)                                      | \$ 2,085        |
| Net current period other comprehensive gain (loss)        | 1,270                                                              | (250)                                                      | -                                             | 1,020           |
| Balance at September 30, 2015                             | <u>\$ 3,726</u>                                                    | <u>\$ (234)</u>                                            | <u>\$ (387)</u>                               | <u>\$ 3,105</u> |
| Balance at December 31, 2015                              | \$ 965                                                             | \$ (60)                                                    | \$ (273)                                      | \$ 632          |
| Net current period other comprehensive income gain (loss) | 4,110                                                              | (301)                                                      | -                                             | 3,809           |
| Balance at September 30, 2016                             | <u>\$ 5,075</u>                                                    | <u>\$ (361)</u>                                            | <u>\$ (273)</u>                               | <u>\$ 4,441</u> |

## (8) 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 rising 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 the undesignated interest rate swap agreements for the first nine months of 2016 were offsetting and therefore had no net effect on Bancorp's earnings or cash flows.

Interest rate swap agreements derive their value from underlying interest rates. These transactions involve both credit and market risk. Notional amounts are amounts on which calculations, payments, and the value of the derivative are based. Notional amounts do not represent direct credit 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, collateral, borrower credit limits and monitoring procedures, and does not expect any counterparties to fail their obligations.

# **STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

At September 30, 2016 and December 31, 2015, Bancorp had outstanding undesignated interest rate swap contracts as follows:

(dollar amounts in thousands)

|                                   | <b>Receiving</b>              |                              | <b>Paying</b>                 |                              |
|-----------------------------------|-------------------------------|------------------------------|-------------------------------|------------------------------|
|                                   | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
| Notional amount                   | \$ 38,706                     | \$ 10,788                    | \$ 38,706                     | \$ 10,788                    |
| Weighted average maturity (years) | 10.2                          | 6.9                          | 10.2                          | 6.9                          |
| Fair value                        | \$ (1,372)                    | \$ (461)                     | \$ 1,372                      | \$ 461                       |

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, 2013 and ends December, 2016. In 2015, Bancorp entered into an interest rate swap to hedge cash flows of a \$20 million rolling fixed-rate three-month FHLB borrowing. The swap began December, 2015 and matures December, 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, 2016 and December 31, 2015.

(dollars in thousands)

| <b>Notional amount</b> | <b>Maturity date</b> | <b>Receive (variable) index</b> | <b>Pay fixed swap rate</b> | <b>Fair value September 30, 2016</b> | <b>Fair value December 31, 2015</b> |
|------------------------|----------------------|---------------------------------|----------------------------|--------------------------------------|-------------------------------------|
| \$ 10,000              | 12/6/2016            | US 3 Month LIBOR                | 0.72%                      | \$ 2                                 | \$ 8                                |
| 20,000                 | 12/6/2020            | US 3 Month LIBOR                | 1.79%                      | (558)                                | (101)                               |
| <u>\$ 30,000</u>       |                      |                                 | <u>1.43%</u>               | <u>\$ (556)</u>                      | <u>\$ (93)</u>                      |

## **(9) 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.

Bancorp recorded a gross core deposit intangible totaling \$2.5 million as a result of its 2013 acquisition of THE BANCORP, Inc. This intangible is being amortized over the expected life of the underlying deposits to which the intangible is attributable. At September 30, 2016, the unamortized core deposit intangible was \$1.5 million.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

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, 2016 and December 31, 2015 were \$2.3 million and \$3.1 million, respectively. Total outstanding principal balances of loans serviced for others were \$374.4 million and \$410.8 million at September 30, 2016, and December 31, 2015, respectively.

Changes in the net carrying amount of MSRs for the nine months ended September 30, 2016 and 2015 are shown in the following table:

| (in thousands)                    | For the nine months<br>ended September 30, |               |
|-----------------------------------|--------------------------------------------|---------------|
|                                   | 2016                                       | 2015          |
| Balance at beginning of period    | \$ 1,018                                   | \$ 1,131      |
| Additions for mortgage loans sold | 105                                        | 306           |
| Amortization                      | (192)                                      | (569)         |
| Balance at September 30           | <u>\$ 931</u>                              | <u>\$ 868</u> |

### (10) 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 \$33 thousand and \$36 thousand, for the three months ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016 and 2015, the net periodic benefit costs totaled \$100 thousand and \$107 thousand, respectively.

### (11) Commitments and Contingent Liabilities

As of September 30, 2016, 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 \$646.6 million including standby letters of credit of \$14.5 million represent normal banking transactions. Commitments to extend credit were \$636.9 million, including letters of credit of \$12.8 million, as of December 31, 2015. 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, 2016, Bancorp has accrued \$317 thousand in other liabilities for inherent risks related to unfunded credit commitments.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

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, 2016, 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.

### **(12) 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.

### **(13) Stock Split**

On April 29, 2016 Bancorp declared a 3 for 2 stock split to be effected as a 50% stock dividend to shareholders of record on May 13, 2016, payable May 27, 2016. Share and per share information has been adjusted for this split.

### **(14) Stock-Based Compensation**

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

Bancorp currently has one stock-based compensation plan. At Bancorp's 2015 Annual Meeting of Shareholders, shareholders approved the 2015 Omnibus Equity Compensation Plan and authorized the shares available from the expiring 2005 plan for future awards under the 2015 plan. No additional shares were made available. As of September 30, 2016, there were 388,339 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 and 2016, forfeitable dividends are deferred until shares are vested.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

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, the fair value of these PSUs is estimated based upon the fair value of the underlying shares on the date of grant, adjusted for non-payment of dividends. Beginning in 2015, grants require a one year post-vesting holding periods. For 2015 and 2016, the fair value of such grants incorporates a liquidity discount of 4.80% and 4.50%, respectively, related to the holding period.

Grants of restricted stock units (“RSUs”) to directors are time-based and vest 12 months after grant date. Because grantees are entitled to deferred dividend payments at the end of the vesting period, fair value of the RSUs is 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<br>September 30, |               | For nine months ended<br>September 30, |                 |
|------------------------------------------------------|-----------------------------------------|---------------|----------------------------------------|-----------------|
|                                                      | 2016                                    | 2015          | 2016                                   | 2015            |
| Stock-based compensation expense before income taxes | \$ 573                                  | \$ 566        | \$ 1,646                               | \$ 1,561        |
| Less: deferred tax benefit                           | (200)                                   | (198)         | (576)                                  | (546)           |
| Reduction of net income                              | <u>\$ 373</u>                           | <u>\$ 368</u> | <u>\$ 1,070</u>                        | <u>\$ 1,015</u> |

Bancorp expects to record an additional \$541 thousand of stock-based compensation expense in 2016 for equity grants outstanding as of September 30, 2016. As of September 30, 2016, Bancorp has \$4.2 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 \$1.6 million and \$2.0 million from the exercise of options during the first nine months of 2016 and 2015, 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:

|                               | 2016       | 2015       |
|-------------------------------|------------|------------|
| Dividend yield                | 2.94%      | 2.97%      |
| Expected volatility           | 19.31%     | 22.81%     |
| Risk free interest rate       | 1.70%      | 1.91%      |
| Expected life of SARs (years) | <u>7.3</u> | <u>7.5</u> |

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. Bancorp evaluates historical exercise and post-vesting termination behavior when determining the expected life.

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

A summary of stock option and SARs activity and related information for the nine months ended September 30, 2016 follows:

|                              | <b>Options<br/>and SARs<br/>(in thousands)</b> | <b>Exercise<br/>price</b> |  | <b>Weighted<br/>average<br/>exercise<br/>price</b> | <b>Aggregate<br/>intrinsic<br/>value<br/>(in thousands)</b> | <b>Weighted<br/>average<br/>fair<br/>value</b> | <b>Weighted<br/>average<br/>remaining<br/>contractual<br/>life (in years)</b> |
|------------------------------|------------------------------------------------|---------------------------|--|----------------------------------------------------|-------------------------------------------------------------|------------------------------------------------|-------------------------------------------------------------------------------|
| <b>At December 31, 2015</b>  |                                                |                           |  |                                                    |                                                             |                                                |                                                                               |
| Vested and exercisable       | 656                                            | \$ 14.02 - 19.44          |  | \$ 15.75                                           | \$ 6,191                                                    | \$ 3.39                                        | 3.7                                                                           |
| Unvested                     | 266                                            | 15.24 - 24.55             |  | 18.66                                              | 1,733                                                       | 3.29                                           | 7.7                                                                           |
| Total outstanding            | 922                                            | 14.02 - 24.55             |  | 16.59                                              | 7,924                                                       | 3.36                                           | 4.8                                                                           |
|                              |                                                |                           |  |                                                    |                                                             |                                                |                                                                               |
| Granted                      | 87                                             | 25.76                     |  | 25.76                                              | 629                                                         | 3.56                                           |                                                                               |
| Exercised                    | (190)                                          | 14.02 - 17.89             |  | 16.36                                              | 2,405                                                       | 3.71                                           |                                                                               |
| Forfeited                    | (3)                                            | 14.02 - 15.84             |  | 15.18                                              | 33                                                          | 2.94                                           |                                                                               |
| <b>At September 30, 2016</b> |                                                |                           |  |                                                    |                                                             |                                                |                                                                               |
| Vested and exercisable       | 556                                            | 14.02 - 24.56             |  | 15.83                                              | 9,533                                                       | 3.25                                           | 4.0                                                                           |
| Unvested                     | 260                                            | 15.24 - 25.76             |  | 21.48                                              | 2,979                                                       | 3.43                                           | 8.0                                                                           |
| Total outstanding            | 816                                            | 14.02 - 25.76             |  | 17.63                                              | \$ 12,512                                                   | 3.31                                           | 5.3                                                                           |
|                              |                                                |                           |  |                                                    |                                                             |                                                |                                                                               |
| Vested year-to-date          | 92                                             | 15.24 - 24.56             |  | 17.46                                              | \$ 1,432                                                    | 3.14                                           |                                                                               |

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.

A summary of activity for the periods ending December 31, 2015 and September 30, 2016 for restricted shares of common stock granted to officers is outlined in the following table:

|                                         | <b>Number</b> | <b>Grant date<br/>weighted-<br/>average cost</b> |
|-----------------------------------------|---------------|--------------------------------------------------|
| Unvested at December 31, 2014           | 171,139       | \$ 16.63                                         |
| Shares awarded                          | 52,898        | 22.99                                            |
| Restrictions lapsed and shares released | (61,205)      | 15.89                                            |
| Shares forfeited                        | (6,974)       | 18.97                                            |
| Unvested at December 31, 2015           | 155,858       | \$ 18.98                                         |
| Shares awarded                          | 51,122        | 25.78                                            |
| Restrictions lapsed and shares released | (48,711)      | 17.94                                            |
| Shares forfeited                        | (12,007)      | 20.69                                            |
| Unvested at September 30, 2016          | 146,262       | \$ 21.55                                         |

# **STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

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.

| <b>Grant year</b> | <b>Vesting period in years</b> | <b>Fair value</b> | <b>Expected shares to be awarded</b> |
|-------------------|--------------------------------|-------------------|--------------------------------------|
| 2014              | 3                              | \$ 17.61          | 50,024                               |
| 2015              | 3                              | 20.02             | 36,337                               |
| 2016              | 3                              | 22.61             | 27,663                               |

In the first quarter of 2016, Bancorp awarded 8,144 RSUs to directors of Bancorp with a grant date fair value of \$200 thousand. In the second quarter of 2016, 1,018 RSUs were cancelled, leaving 7,126 RSUs outstanding with a grant date fair value of \$175 thousand.

## **(15) Net Income Per Share**

The following table reflects, for the three and nine months ended September 30, 2016 and 2015, net income (numerator) and average shares outstanding (denominator) for basic and diluted net income per share computations:

|                                                          | <b>Three months ended<br/>September 30,</b> |             | <b>Nine months ended<br/>September 30,</b> |             |
|----------------------------------------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                                                          | <b>2016</b>                                 | <b>2015</b> | <b>2016</b>                                | <b>2015</b> |
| (In thousands, except per share data)                    |                                             |             |                                            |             |
| Net income                                               | \$ 10,467                                   | \$ 9,284    | \$ 30,411                                  | \$ 27,541   |
| Average shares outstanding                               | 22,385                                      | 22,131      | 22,325                                     | 22,056      |
| Dilutive securities                                      | 418                                         | 348         | 386                                        | 354         |
| Average shares outstanding including dilutive securities | 22,803                                      | 22,479      | 22,711                                     | 22,410      |
| Net income per share, basic                              | \$ 0.47                                     | \$ 0.42     | \$ 1.36                                    | \$ 1.25     |
| Net income per share, diluted                            | \$ 0.46                                     | \$ 0.41     | \$ 1.34                                    | \$ 1.23     |

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

## (16) Segments

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

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

Selected financial information by business segment for the three and nine month periods ended September 30, 2016 and 2015 follows:

| (in thousands)                               | Commercial<br>banking | Wealth<br>management<br>and trust | Total            |
|----------------------------------------------|-----------------------|-----------------------------------|------------------|
| <b>Three months ended September 30, 2016</b> |                       |                                   |                  |
| Net interest income                          | \$ 24,690             | \$ 70                             | \$ 24,760        |
| Provision for loan losses                    | 1,250                 | -                                 | 1,250            |
| Wealth management and trust services         | -                     | 4,800                             | 4,800            |
| All other non-interest income                | 6,558                 | -                                 | 6,558            |
| Non-interest expense                         | 17,722                | 2,796                             | 20,518           |
| Income before income taxes                   | 12,276                | 2,074                             | 14,350           |
| Income tax expense                           | 3,142                 | 741                               | 3,883            |
| Net income                                   | <u>\$ 9,134</u>       | <u>\$ 1,333</u>                   | <u>\$ 10,467</u> |
| <b>Three months ended September 30, 2015</b> |                       |                                   |                  |
| Net interest income                          | \$ 22,034             | \$ 47                             | \$ 22,081        |
| Provision (credit) for loan losses           | -                     | -                                 | -                |
| Wealth 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           |
| Income tax expense                           | 3,720                 | 632                               | 4,352            |
| Net income                                   | <u>\$ 8,141</u>       | <u>\$ 1,143</u>                   | <u>\$ 9,284</u>  |

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

| (in thousands)                              | <b>Commercial<br/>banking</b> | <b>Wealth<br/>management<br/>and trust</b> | <b>Total</b>     |
|---------------------------------------------|-------------------------------|--------------------------------------------|------------------|
| <b>Nine months ended September 30, 2016</b> |                               |                                            |                  |
| Net interest income                         | \$ 71,985                     | \$ 194                                     | \$ 72,179        |
| Provision for loan losses                   | 2,500                         | -                                          | 2,500            |
| Wealth management and trust services        | -                             | 14,219                                     | 14,219           |
| All other non-interest income               | 17,999                        | -                                          | 17,999           |
| Non-interest expense                        | 51,914                        | 8,337                                      | 60,251           |
| Income before income taxes                  | 35,570                        | 6,076                                      | 41,646           |
| Income tax expense                          | 9,064                         | 2,171                                      | 11,235           |
| Net income                                  | <u>\$ 26,506</u>              | <u>\$ 3,905</u>                            | <u>\$ 30,411</u> |
| <b>Nine months ended September 30, 2015</b> |                               |                                            |                  |
| Net interest income                         | \$ 65,350                     | \$ 146                                     | \$ 65,496        |
| Provision (credit) for loan losses          | -                             | -                                          | -                |
| Wealth 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           |
| Income tax expense                          | 10,749                        | 2,007                                      | 12,756           |
| Net income                                  | <u>\$ 23,911</u>              | <u>\$ 3,630</u>                            | <u>\$ 27,541</u> |

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

## (17) Income Taxes

Components of income tax expense from operations were as follows:

| (in thousands)                              | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |           |
|---------------------------------------------|-------------------------------------|----------|------------------------------------|-----------|
|                                             | 2016                                | 2015     | 2016                               | 2015      |
| Current income tax expense                  |                                     |          |                                    |           |
| Federal                                     | \$ 4,363                            | \$ 4,057 | \$ 10,958                          | \$ 11,017 |
| State                                       | 287                                 | 140      | 597                                | 413       |
| Total current income tax expense            | 4,650                               | 4,197    | 11,555                             | 11,430    |
| Deferred income tax expense (benefit)       |                                     |          |                                    |           |
| Federal                                     | (692)                               | 147      | (302)                              | 1,240     |
| State                                       | (75)                                | 8        | (18)                               | 86        |
| Total deferred income tax expense (benefit) | (767)                               | 155      | (320)                              | 1,326     |
| Change in valuation allowance               | -                                   | -        | -                                  | -         |
| Total income tax expense                    | \$ 3,883                            | \$ 4,352 | \$ 11,235                          | \$ 12,756 |

An analysis of the difference between statutory and effective income tax rates for the nine months ended September 30, 2016 and 2015 follows:

|                                                    | Nine months ended September 30, |       |
|----------------------------------------------------|---------------------------------|-------|
|                                                    | 2016                            | 2015  |
| U.S. federal statutory tax rate                    | 35.0%                           | 35.0% |
| Tax exempt interest income                         | (1.3)                           | (1.4) |
| Tax credits                                        | (9.4)                           | (2.4) |
| Increase in cash surrender value of life insurance | (0.9)                           | (0.6) |
| State income taxes, net of federal benefit         | 0.9                             | 0.8   |
| Other, net                                         | 2.7                             | 0.3   |
| Effective income tax rate                          | 27.0%                           | 31.7% |

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. If recognized, tax benefits would reduce tax expense and accordingly, increase net income. The amount of unrecognized tax benefits may increase or decrease in the future for various reasons including adding amounts for current year tax positions, expiration of open income tax returns due to statutes of limitation, changes in management's judgment about the level of uncertainty, status of examination, litigation and legislative activity and addition or elimination of uncertain tax positions. As of September 30, 2016 and December 31, 2015, the gross amount of unrecognized tax benefits was immaterial to the consolidated financial statements of the company. Federal and state income tax returns are subject to examination for the years after 2011.

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY****(18) 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 maximum use of observable inputs and minimum use of unobservable inputs in fair value measurements. Where there exists limited or no observable market data, Bancorp derives its own estimates by generally considering characteristics of the asset/liability, the current economic and competitive environment and other factors. For this reason, results cannot be determined with precision and may not be realized on an actual sale or immediate settlement of the asset or liability.

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

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

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Interest rate swaps are valued using primarily Level 2 inputs. Fair value measurements generally based on benchmark forward yield curves and other relevant observable market data. For purposes of potential valuation adjustments to derivative positions, Bancorp evaluates the credit risk of its counterparties as well as its own credit risk. To date, Bancorp has not realized any losses due to a counterparty's inability to perform and the change in value of derivative assets and liabilities attributable to credit risk was not significant during 2016.

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

| (in thousands)                                        |                   | Fair value at September 30, 2016 |                   |             |  |
|-------------------------------------------------------|-------------------|----------------------------------|-------------------|-------------|--|
| Assets                                                | Total             | Level 1                          | Level 2           | Level 3     |  |
| <b>Investment securities available-for-sale</b>       |                   |                                  |                   |             |  |
| Government sponsored enterprise obligations           | \$ 320,729        | \$ -                             | \$ 320,729        | \$ -        |  |
| Mortgage-backed securities - government agencies      | 161,077           | -                                | 161,077           | -           |  |
| Obligations of states and political subdivisions      | 59,167            | -                                | 59,167            | -           |  |
| Corporate equity securities                           | 708               | 708                              | -                 | -           |  |
| <b>Total investment securities available-for-sale</b> | <b>541,681</b>    | <b>708</b>                       | <b>540,973</b>    | <b>-</b>    |  |
| <b>Interest rate swaps</b>                            | <b>1,372</b>      | <b>-</b>                         | <b>1,372</b>      | <b>-</b>    |  |
| <b>Total assets</b>                                   | <b>\$ 543,053</b> | <b>\$ 708</b>                    | <b>\$ 542,345</b> | <b>\$ -</b> |  |
| <b>Liabilities</b>                                    |                   |                                  |                   |             |  |
| <b>Interest rate swaps</b>                            | <b>\$ 1,928</b>   | <b>\$ -</b>                      | <b>\$ 1,928</b>   | <b>\$ -</b> |  |
|                                                       |                   |                                  |                   |             |  |
| (in thousands)                                        |                   | Fair value at December 31, 2015  |                   |             |  |
| Assets                                                | Total             | Level 1                          | Level 2           | Level 3     |  |
| <b>Investment securities available-for-sale</b>       |                   |                                  |                   |             |  |
| U.S. Treasury and other U.S. government obligations   | \$ 80,000         | \$ 80,000                        | \$ -              | \$ -        |  |
| Government sponsored enterprise obligations           | 251,893           | -                                | 251,893           | -           |  |
| Mortgage-backed securities - government agencies      | 169,628           | -                                | 169,628           | -           |  |
| Obligations of states and political subdivisions      | 63,702            | -                                | 63,702            | -           |  |
| Corporate equity securities                           | 653               | 653                              | -                 | -           |  |
| <b>Total investment securities available-for-sale</b> | <b>565,876</b>    | <b>80,653</b>                    | <b>485,223</b>    | <b>-</b>    |  |
| <b>Interest rate swaps</b>                            | <b>461</b>        | <b>-</b>                         | <b>461</b>        | <b>-</b>    |  |
| <b>Total assets</b>                                   | <b>\$ 566,337</b> | <b>\$ 80,653</b>                 | <b>\$ 485,684</b> | <b>\$ -</b> |  |
| <b>Liabilities</b>                                    |                   |                                  |                   |             |  |
| <b>Interest rate swaps</b>                            | <b>\$ 554</b>     | <b>\$ -</b>                      | <b>\$ 554</b>     | <b>\$ -</b> |  |

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

Bancorp had no financial instruments classified within Level 3 of the valuation hierarchy for assets and liabilities measured at fair value on a recurring basis at September 30, 2016 or December 31, 2015.

MSRs are recorded at fair value upon capitalization, are amortized to correspond with estimated servicing income, and are periodically assessed for impairment based on fair value at the reporting date. Fair value is based on a valuation model that calculates the present value of estimated net servicing income. The model incorporates assumptions that market participants would use in estimating future net servicing income. These measurements are classified as Level 3. At September 30, 2016 and December 31, 2015 there was no valuation allowance for the mortgage servicing rights, as the fair value exceeded the cost. Accordingly, the MSRs are not included in either table below for September 30, 2016 or December 31, 2015. See Note 9 for more information regarding MSRs.

For impaired loans in the table below, the fair value is calculated as the carrying value of only loans with a specific valuation allowance, less the specific allowance. Fair value of impaired loans was primarily measured based on the value of the collateral securing these loans. Impaired loans are classified within Level 3 of the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory, and/or accounts receivable. Bancorp determines the value of the collateral based on independent appraisals performed by qualified licensed appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Appraised values are discounted for costs to sell and may be discounted further based on management's historical knowledge, changes in market conditions from the date of the most recent appraisal, and/or management's expertise and knowledge of the customer and the customer's business. Such discounts by management are subjective and are typically significant unobservable inputs for determining fair value. As of September 30, 2016, total impaired loans with a valuation allowance were \$4.1 million, and the specific allowance totaled \$1.8 million, resulting in a fair value of \$2.3 million, compared with total impaired loans with a valuation allowance of \$2.6 million, and the specific allowance allocation totaling \$544 thousand, resulting in a fair value of \$2.1 million at December 31, 2015. Losses represent the change in specific allowances for the period indicated.

Other real estate owned ("OREO"), which is carried at the lower of cost or fair value, is periodically assessed for impairment based on fair value at the reporting date. Fair value is based on appraisals performed by external parties which use judgments and assumptions that are property-specific and sensitive to changes in the overall economic environment. Appraisals may be further discounted based on management's historical knowledge and/or changes in market conditions from the date of the most recent appraisal. Many of these inputs are not observable and, accordingly, these measurements are classified as Level 3. For OREO in the table below, fair value is the carrying value of only parcels of OREO which have a carrying value equal to appraised value. Losses represent write-downs which occurred during the period indicated. At September 30, 2016 and December 31, 2015, carrying value of all other real estate owned was \$5.0 million and \$4.5 million, respectively.

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

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

| (in thousands)          | Fair value at September 30, 2016 |             |             |                 | Losses for 9 month period ended September 30, 2016 |
|-------------------------|----------------------------------|-------------|-------------|-----------------|----------------------------------------------------|
|                         | Total                            | Level 1     | Level 2     | Level 3         |                                                    |
| Impaired loans          | \$ 2,299                         | \$ -        | \$ -        | \$ 2,299        | \$ (1,612)                                         |
| Other real estate owned | 4,301                            | -           | -           | 4,301           | (62)                                               |
| Total                   | <u>\$ 6,600</u>                  | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 6,600</u> | <u>\$ (1,674)</u>                                  |

| (in thousands)          | Fair value at December 31, 2015 |             |             |                 | Losses for 9 month period ended September 30, 2015 |
|-------------------------|---------------------------------|-------------|-------------|-----------------|----------------------------------------------------|
|                         | Total                           | Level 1     | Level 2     | Level 3         |                                                    |
| Impaired loans          | \$ 2,058                        | \$ -        | \$ -        | \$ 2,058        | \$ (1,147)                                         |
| Other real estate owned | 3,782                           | -           | -           | 3,782           |                                                    |
| Total                   | <u>\$ 5,840</u>                 | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 5,840</u> | <u>\$ (1,147)</u>                                  |

For the securities portfolio, Bancorp monitors the valuation technique used by pricing agencies to ascertain when transfers between levels have occurred. The nature of other assets and liabilities measured at fair value is such that transfers in and out of any level are expected to be rare. For the three months ended September 30, 2016, there were no transfers between Levels 1, 2, or 3. For Level 3 assets measured at fair value on a non-recurring basis as of September 30, 2016, the significant unobservable inputs used in the fair value measurements are presented below.

| (Dollars in thousands)                | Fair Value   | Valuation technique | unobservable input         | average of input |
|---------------------------------------|--------------|---------------------|----------------------------|------------------|
| Impaired loans - collateral dependent | \$ 2,299     | Appraisal           | Appraisal discounts        | 12.3%            |
| Other real estate owned               | <u>4,301</u> | <u>Appraisal</u>    | <u>Appraisal discounts</u> | <u>19.2</u>      |

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

**(19) Disclosure of Financial Instruments Not Reported at Fair Value**

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

| (in thousands)<br><b>September 30, 2016</b>       | <b>Carrying<br/>amount</b> | <b>Fair value</b> | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> |
|---------------------------------------------------|----------------------------|-------------------|----------------|----------------|----------------|
| <b>Financial assets</b>                           |                            |                   |                |                |                |
| Cash and short-term investments                   | \$ 57,893                  | \$ 57,893         | \$ 57,893      | \$ -           | \$ -           |
| Mortgage loans held for sale                      | 5,959                      | 6,206             | -              | 6,206          | -              |
| Federal Home Loan Bank stock and other securities | 6,347                      | 6,347             | -              | 6,347          | -              |
| Loans, net                                        | 2,198,337                  | 2,232,177         | -              | -              | 2,232,177      |
| Accrued interest receivable                       | 6,952                      | 6,952             | 6,952          | -              | -              |
| <b>Financial liabilities</b>                      |                            |                   |                |                |                |
| Deposits                                          | 2,390,597                  | 2,390,642         | -              | -              | 2,390,642      |
| Short-term borrowings                             | 143,702                    | 143,702           | -              | 143,702        | -              |
| FHLB advances                                     | 51,366                     | 53,091            | -              | 53,091         | -              |
| Accrued interest payable                          | 116                        | 116               | 116            | -              | -              |
| <b>(in thousands)<br/>December 31, 2015</b>       |                            |                   |                |                |                |
|                                                   | <b>Carrying<br/>amount</b> | <b>Fair value</b> | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> |
| <b>Financial assets</b>                           |                            |                   |                |                |                |
| Cash and short-term investments                   | \$ 103,833                 | \$ 103,833        | \$ 103,833     | \$ -           | \$ -           |
| Mortgage loans held for sale                      | 6,800                      | 7,112             | -              | 7,112          | -              |
| Federal Home Loan Bank stock and other securities | 6,347                      | 6,347             | -              | 6,347          | -              |
| Loans, net                                        | 2,010,566                  | 2,021,776         | -              | -              | 2,021,776      |
| Accrued interest receivable                       | 6,610                      | 6,610             | 6,610          | -              | -              |
| <b>Financial liabilities</b>                      |                            |                   |                |                |                |
| Deposits                                          | 2,371,702                  | 2,371,300         | -              | -              | 2,371,300      |
| Short-term borrowings                             | 87,003                     | 87,003            | -              | 87,003         | -              |
| FHLB advances                                     | 43,468                     | 43,647            | -              | 43,647         | -              |
| Accrued interest payable                          | 127                        | 127               | 127            | -              | -              |

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

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

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

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

### **Mortgage loans held for sale**

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

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

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

### **Loans, net**

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

### **Deposits**

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

### **Federal Home Loan Bank advances**

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

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

Fair values of commitments to extend credit are estimated using fees currently charged to enter into similar agreements and creditworthiness of customers. Fair values of standby letters of credit are based on fees currently charged for similar agreements or estimated cost to terminate them or otherwise settle obligations with counterparties at the reporting date. Fair value of commitments to extend credit, letters of credit and lines of credit is not presented since management believes the fair value to be insignificant.

### **Limitations**

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

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

## (20) Regulatory Matters

Bancorp and the Bank are subject to various capital requirements prescribed by banking regulations and administered by state and federal banking agencies. Under these requirements, Bancorp and the Bank must meet minimum amounts and percentages of Tier 1, common equity Tier 1, and total capital, as defined, to risk weighted assets and Tier 1 capital to average assets. Risk weighted assets are determined by applying certain risk weightings prescribed by regulation to various categories of assets and off-balance sheet commitments. Capital and risk weighted assets may be further subject to qualitative judgments by regulators as to components, risk weighting and other factors. Failure to meet capital requirements can result in certain mandatory, and possibly discretionary, corrective actions prescribed by regulation or determined to be necessary by regulators, which could materially affect the unaudited consolidated financial statements.

In 2013, the Federal Reserve Board and the FDIC approved rules that substantially amended regulatory risk-based capital rules applicable to Bancorp and the Bank. The rules implemented regulatory capital reforms of the Basel Committee on Banking Supervision reflected in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III) and changes required by the Dodd-Frank Act. Basel III regulatory capital reforms became effective for Bancorp and the Bank on January 1, 2015, and include new minimum risk-based capital and leverage ratios. Bancorp and the Bank met all capital requirements to which they were subject as of September 30, 2016.

The following table sets forth consolidated Bancorp's and the Bank's risk based capital amounts and ratios as of September 30, 2016 and December 31, 2015.

| (Dollars in thousands)<br>September 30, 2016 | Actual     |        | Minimum for adequately<br>capitalized |       | Minimum for well capitalized |       |
|----------------------------------------------|------------|--------|---------------------------------------|-------|------------------------------|-------|
|                                              | Amount     | Ratio  | Amount                                | Ratio | Amount                       | Ratio |
| Total risk-based capital (1)                 |            |        |                                       |       |                              |       |
| Consolidated                                 | \$ 330,597 | 13.05% | \$ 202,665                            | 8.00% | NA                           | NA    |
| Bank                                         | 319,526    | 12.64  | 202,232                               | 8.00  | \$ 252,790                   | 10.00 |
| Common equity tier 1 risk-based capital      |            |        |                                       |       |                              |       |
| Consolidated                                 | 305,886    | 12.07  | 114,042                               | 4.50  | NA                           | NA    |
| Bank                                         | 294,815    | 11.66  | 113,779                               | 4.50  | 151,706                      | 6.00  |
| Tier 1 risk-based capital (1)                |            |        |                                       |       |                              |       |
| Consolidated                                 | 305,886    | 12.07  | 152,056                               | 6.00  | NA                           | NA    |
| Bank                                         | 294,815    | 11.66  | 151,706                               | 6.00  | 151,706                      | 6.00  |
| Leverage (2)                                 |            |        |                                       |       |                              |       |
| Consolidated                                 | 305,886    | 10.63  | 115,103                               | 4.00  | NA                           | NA    |
| Bank                                         | 294,815    | 10.26  | 114,938                               | 4.00  | 143,672                      | 5.00  |

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

| (Dollars in thousands)<br>December 31, 2015    | Actual     |        | Minimum for adequately<br>capitalized |       | Minimum for well capitalized |       |
|------------------------------------------------|------------|--------|---------------------------------------|-------|------------------------------|-------|
|                                                | Amount     | Ratio  | Amount                                | Ratio | Amount                       | Ratio |
| <b>Total risk-based capital (1)</b>            |            |        |                                       |       |                              |       |
| Consolidated                                   | \$ 307,666 | 13.31% | \$ 184,923                            | 8.00% | NA                           | NA    |
| Bank                                           | 298,129    | 12.91  | 184,743                               | 8.00  | \$ 230,929                   | 10.00 |
| <b>Common equity tier 1 risk-based capital</b> |            |        |                                       |       |                              |       |
| Consolidated                                   | 284,793    | 12.32  | 104,023                               | 4.50  | NA                           | NA    |
| Bank                                           | 275,256    | 11.92  | 103,914                               | 4.50  | 138,552                      | 6.00  |
| <b>Tier 1 risk-based capital (1)</b>           |            |        |                                       |       |                              |       |
| Consolidated                                   | 284,793    | 12.32  | 138,698                               | 6.00  | NA                           | NA    |
| Bank                                           | 275,256    | 11.92  | 138,552                               | 6.00  | 138,552                      | 6.00  |
| <b>Leverage (2)</b>                            |            |        |                                       |       |                              |       |
| Consolidated                                   | 284,793    | 10.53  | 108,183                               | 4.00  | NA                           | NA    |
| Bank                                           | 275,256    | 10.19  | 108,049                               | 4.00  | 135,062                      | 5.00  |

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

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

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

**(21) Subsequent Event**

In 2004, Bancorp invested \$1.4 million in Indiana Business Bancorp (“IBB”), and included the investment in other assets. Due to a decline in the market value of the stock, Bancorp recorded an impairment charge totaling \$866 thousand in 2008. In April 2016, Lizton Financial Corporation (“Lizton”) and IBB entered into an agreement for Lizton to acquire all of the shares of IBB for \$7.25 per share. The transaction was completed in October 2016, resulting in a \$588 thousand pre-tax recovery, which was recorded in other income in the fourth quarter of 2016.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

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

This item discusses the results of operations for Stock Yards Bancorp, Inc. ("Bancorp" or "Company"), and its subsidiary, Stock Yards Bank & Trust Company ("Bank") for the three and nine months ended September 30, 2016 and compares these periods with the same periods of the previous year. Unless otherwise indicated, all references in this discussion to the Bank include Bancorp. In addition, the discussion describes changes in the financial condition of Bancorp and the Bank that have occurred during the first nine months of 2016 compared with same periods in the year ended December 31, 2015. This discussion should be read in conjunction with the consolidated financial statements and accompanying notes presented in Part 1, Item 1 of this report.

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

#### Overview of 2016 through September 30

Bancorp completed the first nine months of 2016 with net income of \$30.4 million, a 10.4% increase over the comparable period in 2015. The increase is primarily due to higher net interest income and non-interest income. These increases were partially offset by higher non-interest expense and higher provision for loan losses. Diluted earnings per share for the first nine months of 2016 were \$1.34, compared with the first nine months of 2015 at \$1.23. Bancorp's performance for the first nine months of 2016 reflected several positive factors, including:

- Strong organic net loan growth, accelerating from the pace set over the past two years;
- Continued high credit quality;
- Diverse sources of fee income contributing to revenue growth; and
- Solid returns on average assets and equity of 1.42% and 13.51%, respectively.

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

Net interest income increased \$6.7 million, or 10.2%, for the first nine months of 2016, compared with the same period in 2015. The positive effects of increased volumes of earning assets and lower costs on time deposits were partially offset by the negative effect of declining interest rates earned. Net interest margin declined to 3.60% for the first nine months of 2016, compared with 3.71% for the same period of 2015.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

In response to internal assessment of risk inherent in the loan portfolio, including net loan growth, Bancorp recorded a \$2.5 million provision for loan losses in the first nine months of 2016, compared with no provision in the first nine months of 2015. The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, is adequate to provide coverage for the inherent losses on outstanding loans.

Total non-interest income in the first nine months of 2016 increased \$2.3 million, or 7.8%, compared with the same period in 2015, and comprised 31.6% of total revenues, as compared to 31.3% for the same period in 2015. Bancorp experienced increases in virtually all areas of non-interest income.

Total non-interest expense in the first nine months of 2016 increased \$5.2 million, or 9.4%, compared with the same period in 2015, primarily due to increases in salaries, benefits and expenses related to the Bancorp's expansion in the Cincinnati and Indianapolis markets during 2015. Included are higher amortization expenses for investments in tax-credit partnerships, which resulted in a reduction in the effective tax rate, generating income tax savings that exceeded the amortization expense. These expenses were partially offset by gains on sales of foreclosed assets. Bancorp's efficiency ratio in the first nine months of 2016 was 57.4% compared to 57.3% in the same period in 2015. Excluding amortization of the investments in tax credit partnerships, the adjusted efficiency ratio, a non-GAAP measure, would have been 54.5% and 56.8% for the first nine months of 2016 and 2015, respectively. See the Non-GAAP Financial Measures section for details on reconciliation to US GAAP measures.

Bancorp's effective tax rate decreased to 27.0% in 2016 from 31.7% in 2015. The decrease in the effective tax rate from 2015 to 2016 is largely the result of higher tax credits in 2016.

Tangible common equity (TCE), a non-GAAP measure, is a measure of a company's capital which is useful in evaluating the quality and adequacy of capital. The ratio of tangible common equity to total tangible assets was 10.54% as of September 30, 2016, compared with 10.10% at December 31, 2015. See the Non-GAAP Financial Measures section for details on reconciliation to US GAAP measures.

On April 29, 2016 Bancorp declared a 3 for 2 stock split to be effected as a 50% stock dividend to shareholders of record on May 13, 2016, payable May 27, 2016. Share and per share information has been adjusted for this dividend.

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

### ***a) Results Of Operations***

Net income of \$10.5 million for the three months ended September 30, 2016 increased \$1.2 million, or 12.7%, from \$9.3 million for the comparable 2015 period. This represents a record net income for the second consecutive quarter. Basic net income per share was \$0.47 for the third quarter of 2016, an increase of 11.9% from the \$0.42 for the third quarter of 2015. Net income per share on a diluted basis was \$0.46 for the third quarter of 2016, a record and an increase of 12.2% from the \$0.41 for the same period in 2015. See Note 15 for additional information related to net income per share.

Annualized return on average assets and annualized return on average stockholders' equity were 1.44% and 13.47%, respectively, for the third quarter of 2016, compared with 1.44% and 13.32%, respectively, for the same period in 2015.

Net income of \$30.4 million for the nine months ended September 30, 2016 increased \$2.9 million, or 10.4%, from \$27.5 million for the comparable 2015 period. Basic net income per share was \$1.36 for the first nine months of 2016, an increase of 8.8% from the \$1.25 for the first nine months of 2015. Net income per share on a diluted basis was \$1.34 for the first nine months of 2016, an increase of 8.9% from the \$1.23 for the first nine months of 2015.

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

Annualized return on average assets and annualized return on average stockholders' equity were 1.42% and 13.51%, respectively, for the first nine months of 2016, compared with 1.46% and 13.59%, respectively, for the same period in 2015.

**Net Interest Income**

The following tables present average balance sheets for the three and nine month periods ended September 30, 2016 and 2015 along with the related calculation of tax-equivalent net interest income, net interest margin and net interest spread for the related periods. See the notes following the tables for further explanation.

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

## Average Balances and Interest Rates – Taxable Equivalent Basis

| (Dollars in thousands)                                  | Three months ended September 30 |                  |                 |                     |                  |                 |
|---------------------------------------------------------|---------------------------------|------------------|-----------------|---------------------|------------------|-----------------|
|                                                         | 2016                            |                  |                 | 2015                |                  |                 |
|                                                         | Average<br>balances             | Interest         | Average<br>rate | Average<br>balances | Interest         | Average<br>rate |
| <b>Earning assets:</b>                                  |                                 |                  |                 |                     |                  |                 |
| Federal funds sold and interest bearing deposits        | \$ 72,673                       | \$ 95            | 0.52%           | \$ 86,008           | \$ 65            | 0.30%           |
| Mortgage loans held for sale                            | 5,070                           | 66               | 5.18            | 5,045               | 67               | 5.27            |
| Securities:                                             |                                 |                  |                 |                     |                  |                 |
| Taxable                                                 | 406,481                         | 1,984            | 1.94            | 343,302             | 1,872            | 2.16            |
| Tax-exempt                                              | 59,981                          | 426              | 2.83            | 59,185              | 418              | 2.80            |
| FHLB stock and other securities                         | 6,347                           | 63               | 3.95            | 6,347               | 64               | 4.00            |
| Loans, net of unearned income                           | 2,171,772                       | 23,511           | 4.31            | 1,916,477           | 21,029           | 4.35            |
| <b>Total earning assets</b>                             | <b>2,722,324</b>                | <b>26,145</b>    | <b>3.82</b>     | <b>2,416,364</b>    | <b>23,515</b>    | <b>3.86</b>     |
| Less allowance for loan losses                          | 23,634                          |                  |                 | 23,428              |                  |                 |
|                                                         | 2,698,690                       |                  |                 | 2,392,936           |                  |                 |
| Non-earning assets:                                     |                                 |                  |                 |                     |                  |                 |
| Cash and due from banks                                 | 41,682                          |                  |                 | 39,840              |                  |                 |
| Premises and equipment                                  | 42,665                          |                  |                 | 40,274              |                  |                 |
| Accrued interest receivable and other assets            | 100,109                         |                  |                 | 87,630              |                  |                 |
| <b>Total assets</b>                                     | <b>\$ 2,883,146</b>             |                  |                 | <b>\$ 2,560,680</b> |                  |                 |
| <b>Interest bearing liabilities:</b>                    |                                 |                  |                 |                     |                  |                 |
| Deposits:                                               |                                 |                  |                 |                     |                  |                 |
| Interest bearing demand deposits                        | \$ 698,874                      | \$ 232           | 0.13%           | \$ 516,090          | \$ 130           | 0.10%           |
| Savings deposits                                        | 136,292                         | 11               | 0.03            | 121,031             | 10               | 0.03            |
| Money market deposits                                   | 655,912                         | 346              | 0.21            | 644,107             | 330              | 0.20            |
| Time deposits                                           | 247,237                         | 352              | 0.57            | 275,949             | 430              | 0.62            |
| Securities sold under agreements to repurchase          | 68,835                          | 38               | 0.22            | 71,144              | 42               | 0.23            |
| Federal funds purchased and other short term borrowings | 23,471                          | 19               | 0.32            | 16,156              | 7                | 0.17            |
| FHLB advances                                           | 44,194                          | 184              | 1.66            | 42,732              | 254              | 2.36            |
| <b>Total interest bearing liabilities</b>               | <b>1,874,815</b>                | <b>1,182</b>     | <b>0.25</b>     | <b>1,687,209</b>    | <b>1,203</b>     | <b>0.28</b>     |
| <b>Non-interest bearing liabilities:</b>                |                                 |                  |                 |                     |                  |                 |
| Non-interest bearing demand deposits                    | 656,689                         |                  |                 | 572,406             |                  |                 |
| Accrued interest payable and other liabilities          | 42,597                          |                  |                 | 24,502              |                  |                 |
| <b>Total liabilities</b>                                | <b>2,574,101</b>                |                  |                 | <b>2,284,117</b>    |                  |                 |
| <b>Stockholders' equity</b>                             | <b>309,045</b>                  |                  |                 | <b>276,563</b>      |                  |                 |
| <b>Total liabilities and stockholders' equity</b>       | <b>\$ 2,883,146</b>             |                  |                 | <b>\$ 2,560,680</b> |                  |                 |
| <b>Net interest income</b>                              |                                 | <b>\$ 24,963</b> |                 |                     | <b>\$ 22,312</b> |                 |
| <b>Net interest spread</b>                              |                                 |                  | <b>3.57%</b>    |                     |                  | <b>3.58%</b>    |
| <b>Net interest margin</b>                              |                                 |                  | <b>3.65%</b>    |                     |                  | <b>3.66%</b>    |

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

|                                                         | Nine months ended September 30 |                  |                 |                     |                  |                 |
|---------------------------------------------------------|--------------------------------|------------------|-----------------|---------------------|------------------|-----------------|
|                                                         | 2016                           |                  |                 | 2015                |                  |                 |
|                                                         | Average<br>balances            | Interest         | Average<br>rate | Average<br>balances | Interest         | Average<br>rate |
| (Dollars in thousands)                                  |                                |                  |                 |                     |                  |                 |
| <b>Earning assets:</b>                                  |                                |                  |                 |                     |                  |                 |
| Federal funds sold and interest bearing deposits        | \$ 100,653                     | \$ 395           | 0.52%           | \$ 76,508           | \$ 184           | 0.32%           |
| Mortgage loans held for sale                            | 4,918                          | 185              | 5.02            | 5,464               | 180              | 4.40            |
| Securities:                                             |                                |                  |                 |                     |                  |                 |
| Taxable                                                 | 413,508                        | 6,135            | 1.98            | 349,494             | 5,749            | 2.20            |
| Tax-exempt                                              | 61,417                         | 1,298            | 2.82            | 59,516              | 1,255            | 2.82            |
| FHLB stock and other securities                         | 6,347                          | 190              | 4.00            | 6,347               | 190              | 4.00            |
| Loans, net of unearned income                           | 2,113,744                      | 68,238           | 4.31            | 1,888,839           | 62,273           | 4.41            |
| <b>Total earning assets</b>                             | <b>2,700,587</b>               | <b>76,441</b>    | <b>3.78</b>     | <b>2,386,168</b>    | <b>69,831</b>    | <b>3.91</b>     |
| Less allowance for loan losses                          | 23,057                         |                  |                 | 24,437              |                  |                 |
|                                                         | 2,677,530                      |                  |                 | 2,361,731           |                  |                 |
| Non-earning assets:                                     |                                |                  |                 |                     |                  |                 |
| Cash and due from banks                                 | 40,097                         |                  |                 | 38,196              |                  |                 |
| Premises and equipment                                  | 41,500                         |                  |                 | 39,981              |                  |                 |
| Accrued interest receivable and other assets            | 94,263                         |                  |                 | 88,590              |                  |                 |
| <b>Total assets</b>                                     | <b>\$ 2,853,390</b>            |                  |                 | <b>\$ 2,528,498</b> |                  |                 |
| <b>Interest bearing liabilities:</b>                    |                                |                  |                 |                     |                  |                 |
| Deposits:                                               |                                |                  |                 |                     |                  |                 |
| Interest bearing demand deposits                        | \$ 710,417                     | \$ 735           | 0.14%           | \$ 511,325          | \$ 393           | 0.10%           |
| Savings deposits                                        | 134,004                        | 35               | 0.03            | 118,126             | 31               | 0.04            |
| Money market deposits                                   | 652,406                        | 1,060            | 0.22            | 651,185             | 985              | 0.20            |
| Time deposits                                           | 254,172                        | 1,086            | 0.57            | 289,788             | 1,402            | 0.65            |
| Securities sold under agreements to repurchase          | 60,438                         | 100              | 0.22            | 64,541              | 111              | 0.23            |
| Federal funds purchased and other short term borrowings | 25,021                         | 57               | 0.30            | 15,484              | 19               | 0.16            |
| FHLB advances                                           | 43,533                         | 552              | 1.69            | 40,196              | 694              | 2.31            |
| <b>Total interest bearing liabilities</b>               | <b>1,879,991</b>               | <b>3,625</b>     | <b>0.26</b>     | <b>1,690,645</b>    | <b>3,635</b>     | <b>0.29</b>     |
| <b>Non-interest bearing liabilities:</b>                |                                |                  |                 |                     |                  |                 |
| Non-interest bearing demand deposits                    | 637,812                        |                  |                 | 541,919             |                  |                 |
| Accrued interest payable and other liabilities          | 34,844                         |                  |                 | 24,979              |                  |                 |
| <b>Total liabilities</b>                                | <b>2,552,647</b>               |                  |                 | <b>2,257,543</b>    |                  |                 |
| <b>Stockholders' equity</b>                             | <b>300,743</b>                 |                  |                 | <b>270,955</b>      |                  |                 |
| <b>Total liabilities and stockholders' equity</b>       | <b>\$ 2,853,390</b>            |                  |                 | <b>\$ 2,528,498</b> |                  |                 |
| <b>Net interest income</b>                              |                                | <b>\$ 72,816</b> |                 |                     | <b>\$ 66,196</b> |                 |
| <b>Net interest spread</b>                              |                                |                  | <b>3.52%</b>    |                     |                  | <b>3.62%</b>    |
| <b>Net interest margin</b>                              |                                |                  | <b>3.60%</b>    |                     |                  | <b>3.71%</b>    |

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

Notes to the average balance and interest rate tables:

- Net interest income, the most significant component of the Bank's earnings is total interest income less total interest expense. The level of net interest income is determined by mix and volume of interest earning assets, interest bearing deposits and borrowed funds, and changes in interest rates.
- Net interest spread is the difference between taxable equivalent rates earned on interest earning assets less the rate expensed on interest bearing liabilities.
- Net interest margin represents net interest income on a taxable equivalent basis as a percentage of average interest earning assets. Net interest margin is affected by both interest rate spread and the level of non-interest bearing sources of funds, primarily consisting of demand deposits and stockholders' equity.
- Interest income on a fully tax equivalent basis includes additional amounts of interest income that would have been earned if investments in certain tax-exempt interest earning assets had been made in assets subject to federal taxes yielding the same after-tax income. Interest income on municipal securities and tax-exempt loans has been calculated on a fully tax equivalent basis using a federal income tax rate of 35%. Approximate tax equivalent adjustments to interest income were \$203 thousand and \$231 thousand, respectively, for the three month periods ended September 30, 2016 and 2015 and \$637 thousand and \$700 thousand, respectively, for the nine month periods ended September 30, 2016 and 2015.
- Average balances for loans include the principal balance of non-accrual loans and exclude participation loans accounted for as secured borrowings. These participation loans averaged \$16.3 million and \$7.3 million, respectively, for the three month periods ended September 30, 2016 and 2015 and \$11.2 million and \$7.8 million, respectively, for the nine month periods ended September 30, 2016 and 2015.

Fully taxable equivalent net interest income of \$25.0 million for the three months ended September 30, 2016 increased \$2.7 million, or 11.9%, from \$22.3 million for the same period in 2015. Positive effects of increased volumes on loans and lower costs on time deposits and FHLB advances were partially offset by the negative effect of declining interest rates earned on loans. Net interest spread and net interest margin were 3.57% and 3.65%, respectively, for the third quarter of 2016 and 3.58% and 3.66%, respectively, for the third quarter of 2015.

Fully taxable equivalent net interest income of \$72.8 million for the nine months ended September 30, 2016 increased \$6.6 million, or 10.0%, from \$66.2 million for the same period in 2015. Positive effects of increased volumes on earning assets and lower costs on time deposits and FHLB advances were partially offset by the negative effect of declining interest rates earned. Net interest spread and net interest margin were 3.52% and 3.60%, respectively, for the first nine months of 2016 and 3.62% and 3.71%, respectively, for the first nine months of 2015.

Average earning assets increased \$314.4 million or 13.2%, to \$2.7 billion for the first nine months of 2016 as compared with 2015, reflecting increases in the loan portfolio, available-for-sale investments, federal funds sold and interest bearing deposits. Average interest bearing liabilities increased \$189.3 million, or 11.2%, to \$1.9 billion for the first nine months of 2016 as compared with the same period in 2015 primarily due to increases in interest bearing demand and savings deposits, federal funds purchased and FHLB advances, partially offset by decreases in time deposits and securities sold under agreements to repurchase.

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY****Asset/Liability Management and Interest Rate Risk**

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

**Interest Rate Simulation Sensitivity Analysis**

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

Bancorp assumes certain correlation rates, often referred to as a “beta” of interest-bearing deposits, wherein the rates paid to customers change at a different pace when compared with changes in benchmark interest rates. Generally, certificates of deposit are assumed to have a high correlation rate, while interest-bearing checking accounts are assumed to have a lower correlation rate. Actual results may differ due to factors including competitive pricing and money supply; however, Bancorp uses its historical experience as well as industry data to inform its assumptions.

The September 30, 2016 simulation analysis, which shows little interest rate sensitivity, indicates that an increase in interest rates of 100 to 200 basis points would have a negative effect on net interest income, and a decrease of 100 basis points in interest rates would also have a negative impact. The scenario of rates decreasing 200 bp is not reasonably possible given current low rates for short-term instruments and most deposits.

These estimates are summarized below.

|                | <b>Net interest income<br/>change</b> |
|----------------|---------------------------------------|
| Increase 200bp | (1.10)%                               |
| Increase 100bp | (1.13)                                |
| Decrease 100bp | (3.69)                                |
| Decrease 200bp | N/A                                   |

Management expects that net interest margin will remain under pressure for both loans and deposits through 2016, primarily as a result of the current competitive environment. A near term increase in short term interest rates of 25 bps could benefit Bancorp if deposit rates do not rise, whereas rates on earning assets, such as loans, federal funds sold, and interest bearing deposits, rise. While that was the result of the most recent rate increase by the Federal Reserve, such results are not guaranteed. Approximately 64% of the Bancorp’s loan portfolio has fixed rates and 12% of its loan portfolio is priced at variable rates with floors of 4% or higher. Since the prime rate is currently 3.50%, a rise in rates could have a negative impact on net interest income because interest rates would need to move more than 50 bps before rising rates could affect loans with floors, whereas deposit rates could adjust immediately. This effect is captured in the simulation analysis above.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Undesignated derivative instruments described in Note 8 are recognized on the consolidated balance sheet at fair value, with changes in fair value, due to changes in prevailing interest rates, recorded in other non-interest income or non-interest expense. Because of matching terms of offsetting contracts, in addition to collateral provisions which mitigate the impact of non-performance risk, changes in fair value subsequent to initial recognition have a minimal effect on earnings, and are therefore not included in the simulation analysis results above.

Derivatives designated as cash flow hedges described in Note 8 are recognized on the consolidated balance sheet at fair value, with changes in fair value, due to changes in prevailing interest rates, recorded net of tax in other comprehensive income (loss).

### **Provision for Loan Losses**

The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, is adequate to provide coverage for inherent losses on outstanding loans. The allowance for loan losses is calculated after considering credit quality factors, and ultimately relies on an overall internal analysis of risk in the loan portfolio. Based on this analysis, the provision for loan losses is determined and recorded. The provision reflects an allowance methodology that is driven by risk ratings, historical losses, and qualitative factors. Bancorp recorded a \$2.5 million provision for loan losses in the first nine months of 2016, compared with no provision for the same period of 2015.

Management uses loan grading procedures which result in specific allowance allocations for estimated inherent risk of loss. For all loans graded, but not individually reviewed for allowance purposes, a general allowance allocation is computed using historical data based on actual loss experience. Specific and general allocations plus consideration of qualitative factors represent management's best estimate of probable losses contained in the loan portfolio at the evaluation date. Although the allowance for loan losses is comprised of specific and general allocations, the entire allowance is available to absorb any credit losses. Based on this detailed analysis of credit risk, management considers the allowance for loan losses adequate to cover probable losses inherent in the loan portfolio at September 30, 2016.

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

An analysis of the changes in the allowance for loan losses and selected ratios for the three and nine month periods ended September 30, 2016 and 2015 follows:

(Dollars in thousands)

|                                                | Three months ended September 30, |              | Nine months ended September 30, |              |
|------------------------------------------------|----------------------------------|--------------|---------------------------------|--------------|
|                                                | 2016                             | 2015         | 2016                            | 2015         |
| Balance at the beginning of the period         | \$ 23,141                        | \$ 23,308    | \$ 22,441                       | \$ 24,920    |
| Provision for loan losses                      | 1,250                            | -            | 2,500                           | -            |
| Loan charge-offs, net of recoveries            | (22)                             | (1,694)      | (572)                           | (3,306)      |
| Balance at the end of the period               | \$ 24,369                        | \$ 21,614    | \$ 24,369                       | \$ 21,614    |
| Average loans, net of unearned income          | \$ 2,188,089                     | \$ 1,923,762 | \$ 2,124,921                    | \$ 1,896,592 |
| Provision for loan losses to average loans (1) | 0.06%                            | 0.00%        | 0.12%                           | 0.00%        |
| Net loan charge-offs to average loans (1)      | 0.00%                            | 0.09%        | 0.03%                           | 0.17%        |
| Allowance for loan losses to average loans     | 1.11%                            | 1.12%        | 1.15%                           | 1.14%        |
| Allowance for loan losses to period-end loans  | 1.10%                            | 1.11%        | 1.10%                           | 1.11%        |

(1) Amounts not annualized

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

An analysis of net charge-offs by loan category for the three and nine month periods ended September 30, 2016 and 2015 follows:

(in thousands)

|                                                          | Three months ended September 30, |                 | Nine months ended September 30, |                 |
|----------------------------------------------------------|----------------------------------|-----------------|---------------------------------|-----------------|
|                                                          | 2016                             | 2015            | 2016                            | 2015            |
| <b>Net loan charge-offs (recoveries)</b>                 |                                  |                 |                                 |                 |
| Commercial and industrial                                | \$ 18                            | \$ 1,983        | \$ 375                          | \$ 3,299        |
| Construction and development, excluding undeveloped land | (11)                             | 0               | (21)                            | -               |
| Undeveloped land                                         | 0                                | (650)           | -                               | (650)           |
| Real estate mortgage - commercial investment             | (67)                             | 122             | (226)                           | 353             |
| Real estate mortgage - owner occupied commercial         | (9)                              | 108             | 305                             | 97              |
| Real estate mortgage - 1-4 family residential            | 64                               | 78              | 63                              | 127             |
| Home equity                                              | (34)                             | (15)            | (34)                            | (7)             |
| Consumer                                                 | 61                               | 68              | 110                             | 87              |
| <b>Total net loan charge-offs</b>                        | <u>\$ 22</u>                     | <u>\$ 1,694</u> | <u>\$ 572</u>                   | <u>\$ 3,306</u> |

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

## Non-interest Income and Expenses

The following table sets forth major components of non-interest income and expenses for the three and nine month periods ended September 30, 2016 and 2015.

| (In thousands)                                        | Three months<br>ended September 30, |                  |              | Nine months<br>ended September 30, |                  |             |
|-------------------------------------------------------|-------------------------------------|------------------|--------------|------------------------------------|------------------|-------------|
|                                                       | 2016                                | 2015             | % Change     | 2016                               | 2015             | % Change    |
| <b>Non-interest income:</b>                           |                                     |                  |              |                                    |                  |             |
| Wealth management and trust services                  | \$ 4,800                            | \$ 4,373         | 9.8%         | \$ 14,219                          | \$ 13,576        | 4.7%        |
| Service charges on deposit accounts                   | 2,544                               | 2,342            | 8.6          | 6,952                              | 6,621            | 5.0         |
| Bankcard transaction                                  | 1,455                               | 1,223            | 19.0         | 4,198                              | 3,591            | 16.9        |
| Mortgage banking                                      | 1,072                               | 772              | 38.9         | 2,896                              | 2,513            | 15.2        |
| Securities brokerage                                  | 558                                 | 585              | (4.6)        | 1,539                              | 1,545            | (0.4)       |
| Bank owned life insurance                             | 216                                 | 222              | (2.7)        | 657                                | 670              | (1.9)       |
| Other                                                 | 713                                 | 468              | 52.4         | 1,757                              | 1,361            | 29.1        |
| Total non-interest income                             | <u>\$ 11,358</u>                    | <u>\$ 9,985</u>  | <u>13.8%</u> | <u>\$ 32,218</u>                   | <u>\$ 29,877</u> | <u>7.8%</u> |
| <b>Non-interest expenses:</b>                         |                                     |                  |              |                                    |                  |             |
| Salaries and employee benefits                        | \$ 12,048                           | \$ 11,333        | 6.3%         | \$ 36,214                          | \$ 33,816        | 7.1%        |
| Net occupancy                                         | 1,646                               | 1,518            | 8.4          | 4,716                              | 4,437            | 6.3         |
| Data processing                                       | 1,747                               | 1,572            | 11.1         | 5,172                              | 4,782            | 8.2         |
| Furniture and equipment                               | 277                                 | 282              | (1.8)        | 853                                | 789              | 8.1         |
| FDIC insurance                                        | 356                                 | 318              | 11.9         | 1,035                              | 932              | 11.1        |
| Amortization of investment in tax credit partnerships | 1,015                               | 158              | 542.4        | 3,046                              | 475              | 541.3       |
| Other                                                 | 3,429                               | 3,249            | 5.5          | 9,215                              | 9,845            | (6.4)       |
| Total non-interest expenses                           | <u>\$ 20,518</u>                    | <u>\$ 18,430</u> | <u>11.3%</u> | <u>\$ 60,251</u>                   | <u>\$ 55,076</u> | <u>9.4%</u> |

The largest component of non-interest income is revenue from the Bancorp's wealth management and trust ("WM&T") department. The magnitude of WM&T revenue distinguishes Bancorp from other community banks of similar asset size. Wealth management and trust's revenue is accelerating due largely to new account growth, with approximately \$2.4 billion in assets under management as of September 30, 2016, as compared with \$2.2 billion at September 30, 2015. WM&T services revenue, which constitutes an year-to-date average of 44% of non-interest income, increased \$427 thousand, or 9.8%, for the third quarter of 2016, and \$643 thousand, or 4.7% for the first nine months of 2016, as compared with the same periods in 2015. Recurring revenues, which generally comprise over 95% of the wealth management and trust revenue, increased \$473 thousand, or 3.6%, for the first nine months of 2016, compared with the same period of 2015. Most recurring revenue earned for managing accounts is based on a percentage of market value on a monthly basis. Some revenues of the WM&T department, most notably executor, insurance, and some employee benefit plan-related fees, are non-recurring in nature and the timing of these revenues corresponds with the related administrative activities. Total non-recurring revenue increased \$170 thousand for the first nine months of 2016, compared with the same period in 2015, primarily due to estate fees earned. Management believes that the new account growth in the WM&T department provides a strong foundation for future earnings and factors significantly into Bancorp's future financial results while providing strategic diversity to revenue streams.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Service charges on deposit accounts increased \$202 thousand, or 8.6%, in the third quarter of 2016, and \$331 thousand, or 5.0%, for the first nine months of 2016, as compared with the same periods in 2015. The increases for 2016 are primarily due to introduction of a new checking account product with ancillary benefits, added this year. This new product provided approximately \$166 thousand in service charge income for the third quarter of 2016. Another significant component of service charges is related to fees earned on overdrawn checking accounts. Management expects this source of revenue to slowly decline due to anticipated changes in customer behavior and ongoing regulatory restrictions. This component of service charge income is generally driven by transaction volume, which can fluctuate throughout the year.

Bankcard transaction revenue increased \$232 thousand, or 19.0%, in the third quarter of 2016, and \$607 thousand, or 16.9% for the first nine months of 2016, as compared with the same periods in 2015. Bankcard transaction revenue primarily represents income the Bank derives from customers' use of debit and credit cards. Interchange income on debit cards increased slightly for both the three and nine-month periods, primarily a result of increased volume, however, Bancorp expects a slight decrease in interchange rates on debit cards as service providers gravitate to lower cost options in a competitive market. Late in 2015, Bancorp began offering credit cards to business customers. Revenue on credit cards totaled \$206,000 for the third quarter and \$520,000 for the first nine months of 2016. Bancorp expects volume of credit card transactions to increase as customers are added.

Mortgage banking revenue primarily includes gains on sales of mortgage loans. Bancorp's mortgage banking department originates residential mortgage loans to be sold in the secondary market. Interest rates on the loans sold are locked with the borrower and investor prior to closing the loans, thus Bancorp bears no interest rate risk related to these loans. The department offers conventional, VA and FHA financing, for purchases and refinances, as well as programs for first-time home buyers. Interest rates on mortgage loans directly impact the volume of business transacted by the mortgage banking department. Mortgage banking revenue increased \$300 thousand, or 38.9%, in the third quarter of 2016, and \$383 thousand or 15.2%, for the first nine months of 2016, as compared with the same periods in 2015, attributable mainly to slightly higher sales prices on loans. Rates declined in 2016 compared with the same period in 2015, stimulating refinancing activity during the third quarter of 2016. The impact of the additional refinance activity was partially offset by a slight decline in purchasing activity for the period.

Brokerage commissions and fees decreased slightly for the three and nine-month periods, as compared with the same periods in 2015. These decreases correspond primarily to overall brokerage volume. Brokerage commissions and fees earned consist primarily of stock, bond and mutual fund sales as well as wrap fees on accounts. Wrap fees are charges for investment programs that bundle together a suite of services, such as brokerage, advisory, research and management, and are based on a percentage of assets. Bancorp deploys its brokers primarily through its branch network via an arrangement with a third party broker-dealer, while larger managed accounts are serviced in the Bank's WM&T department.

Bank Owned Life Insurance (BOLI) income totaled \$216 thousand and \$222 thousand for the third quarter of 2016 and 2015, respectively, and totaled \$657 thousand and \$670 thousand for the first nine months of 2016 and 2015, respectively. BOLI represents the cash surrender value for life insurance policies on certain key employees who have provided consent for Bancorp to be the beneficiary of a portion of such policies. BOLI income results from the related change in cash surrender value and any death benefits received under the policies. This income helps offset the cost of various employee benefits.

Other non-interest income increased \$245 thousand, or 52.4%, for the third quarter of 2016, and \$396 thousand, or 29.1% for the first nine months of 2016, as compared with the same periods in 2015. Included in this category is swap fee income, which totaled \$436 thousand and \$17 thousand for the first nine months of 2016 and 2015, respectively. Opportunities to earn swap fee income are infrequent due to the specialized nature of the transactions. This category includes a variety of other income sources, none of which resulted in individually significant variances.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Salaries and employee benefits increased \$715 thousand, or 6.3%, for the third quarter of 2016, and \$2.4 million, or 7.1% for the first nine months of 2016, as compared with the same periods of 2015. For the third quarter and the first nine months, the increase is largely due to higher compensation expenses, reflecting both increased incentive compensation related to accelerated loan and earnings growth as well as the addition of personnel associated with continued expansion in the Cincinnati and Indianapolis markets. These increases were partially offset by lower health insurance costs. The Bank's employee health insurance is a self-insured plan and related expenses fluctuate with claims experience. At September 30, 2016, Bancorp had 558 full-time equivalent employees compared with 546 at September 30, 2015.

Net occupancy expense increased \$128 thousand, or 8.4%, in the third quarter of 2016, and \$279 thousand, or 6.3%, for the first nine months of 2016, as compared with the same periods of 2015. The increase was largely due to higher rent and depreciation for locations added during 2015 and increased maintenance expense company-wide.

Data processing expense increased \$175 thousand, or 11.1% in the third quarter of 2016, and \$390 thousand, or 8.2% for the first nine months of 2016, compared with the same periods of 2015, primarily due to increases in computer maintenance and repair costs resulting from system improvements and expenses related to the issuance and processing of business credit cards. This category includes ongoing computer software amortization, equipment depreciation, and expenditures related to investments in technology needed to maintain and improve the quality of delivery channels and internal resources.

Furniture and equipment expense increased \$64 thousand, or 8.1% for the first nine months of 2016, as compared with the same periods in 2015. For the third quarter there was a minimal decrease over the comparable period in 2015. These fluctuations relate to a variety of factors, none of which were individually significant. Costs of capital asset additions flow through the statement of income over the lives of the assets in the form of depreciation expense.

FDIC insurance expense increased \$38 thousand, or 11.9%, for the third quarter of 2016, and \$103 thousand or 11.1% for the first nine months of 2016, as compared with the same periods in 2015. The assessment is calculated by the FDIC and adjusted quarterly. The increase in expense is due primarily to higher level of net assets driven by loan growth.

Amortization of investments in tax credit partnerships increased \$857 thousand for the third quarter of 2016, and \$2.6 million for the first nine months of 2016, compared with the same periods of 2015. This expense reflects amortization of investments in partnerships which generate historic income tax credits and vary widely depending upon the timing of investments and related amortization. For each of Bancorp's investments in tax credit partnerships, when taken as a whole, the tax benefit compared with the amortization results in a positive effect on net income. See the Income Taxes section below for details on amortization and income tax impact for these credits.

Other non-interest expenses increased \$180 thousand or 5.5% in the third quarter of 2016, but decreased \$630 thousand or 6.4% for the first nine months of 2016, as compared with the same periods in 2015. The decreases for the nine month period are largely due to \$382 thousand of net gains on sales of foreclosed assets in 2016 compared with \$153 thousand of net losses in 2015. Additionally, Bancorp reduced the reserve for estimated losses on unfunded commitments by \$115 thousand in the first nine months of 2016, compared with a provision expense of \$372 thousand in 2015. This reserve is based on evaluation of credit risk related to available lines of credit in the loan portfolio and will fluctuate based on borrowers' use and repayment of those lines. MSR amortization declined \$375 thousand for the first nine months of 2016 compared with 2015, as pools of MSRs added several years ago were fully amortized in 2015. Other non-interest expense also includes legal and professional fees, advertising, printing, mail and telecommunications, none of which had individually significant variances.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

### Income Taxes

For the first nine months of 2016, Bancorp recorded income tax expense of \$11.2 million, compared with \$12.8 million for the same period in 2015. The effective rate for the nine month period was 27.0% in 2016 and 31.7% in 2015. The decrease in the effective tax rate from 2015 to 2016 is largely the result of higher utilization of tax credits in 2016.

Bancorp invests in certain partnerships that yield historic and low-income housing tax credits. The amortization method for investments in historic tax credit partnerships is the cost method which matches the amortization period with the time frame over which the credits are realized. The tax benefits and related investment amortization expenses for low-income housing credits are recognized in income tax expense using a proportional amortization method which amortizes the investment in proportion to the tax credits and other tax benefits received.

### Commitments

Bancorp uses a variety of financial instruments in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. A discussion of Bancorp's commitments is included in Note 11.

Other commitments discussed in Bancorp's Annual Report on Form 10-K for the year ended December 31, 2015, have not materially changed since that report was filed, relative to qualitative and quantitative disclosures of fixed and determinable contractual obligations.

## ***b) Financial Condition***

### Balance Sheet

Total assets increased \$121.9 million, or 4.3%, from \$2.8 billion on December 31, 2015 to \$2.9 billion on September 30, 2016. In the first nine months of 2016 loans grew \$189.7 million, or 9.3%, a result of loan production which outpaced what had previously been record production in 2015. All of the growth has been organic and each of Bancorp's three markets continues to participate in the accelerated lending activity. Loan growth during the nine month period reflects ongoing expansion in key categories, such as commercial and industrial lending, while limiting exposure to commercial investment real estate. Securities available-for-sale decreased by \$24.2 million over the first nine months of 2016. The decrease was net of market value changes in the portfolio as unrealized gains of \$1.5 million at December 31, 2015 increased to \$7.8 million at September 30, 2016, a \$6.3 million increase in the market value of the portfolio. Maturing available-for-sale investments were used to fund loan growth during the first nine months of 2016. Included in securities available-for-sale are short term obligations of U.S. Treasury or U.S. government sponsored entities. These securities, which totaled \$100 million at September 30, 2016 and December 31, 2015, normally have a maturity of less than one month, and are purchased at quarter-end as part of a tax minimization strategy.

Total liabilities increased \$96.8 million, or 3.8%, from \$2.5 billion on December 31, 2015 to \$2.6 billion on September 30, 2016. Total deposits increased \$18.9 million or 0.8%, with the greatest increase in non-interest bearing deposit accounts. Non-interest bearing deposit accounts increased \$96.3 million, or 16.5%, whereas interest bearing accounts decreased \$77.4 million, or 4.3%, over the nine month period. Securities sold under agreements to repurchase increased \$2.8 million or 4.3% due to normal cyclical activity. Federal funds purchased and other short-term borrowing increased \$53.9 million. Bancorp uses short-term lines of credit to manage its overall liquidity position. Other liabilities increased \$13.3 million or 47.6% largely due to an increase in secured borrowing related to participation loans. See the Elements of Loan Portfolio section below on details related to participations loans.

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

## Elements of Loan Portfolio

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

(in thousands)

| <b>Loans by Type</b>                                     | <b>September 30, 2016</b> | <b>December 31, 2015</b> |
|----------------------------------------------------------|---------------------------|--------------------------|
| Commercial and industrial                                | \$ 708,508                | \$ 644,398               |
| Construction and development, excluding undeveloped land | 171,994                   | 134,482                  |
| Undeveloped land (1)                                     | 19,993                    | 21,185                   |
| Real estate mortgage:                                    |                           |                          |
| Commercial investment                                    | 510,128                   | 436,989                  |
| Owner occupied commercial                                | 412,733                   | 420,666                  |
| 1-4 family residential                                   | 245,229                   | 226,575                  |
| Home equity - first lien                                 | 54,837                    | 50,115                   |
| Home equity - junior lien                                | 65,605                    | 63,066                   |
| Subtotal: real estate mortgage                           | 1,288,532                 | 1,197,411                |
| Consumer                                                 | 33,679                    | 35,531                   |
| <b>Total loans</b>                                       | <b>\$ 2,222,706</b>       | <b>\$ 2,033,007</b>      |

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

Bancorp occasionally enters into loan participation agreements with other banks to diversify credit risk. For certain sold participation loans, Bancorp has retained effective control of the loans, typically by restricting the participating institutions from pledging or selling their share of the loan without permission from Bancorp. US GAAP requires the participated portion of these loans to be recorded as secured borrowings. These participated loans are included in the commercial and industrial and real estate mortgage loan totals above, and a corresponding liability is recorded in other liabilities. At September 30, 2016 and December 31, 2015, the total participated portions of loans of this nature were \$16.0 million and \$7.2 million, respectively.

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

## Non-performing Loans and Assets

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

| (Dollars in thousands)                                | September 30, 2016 | December 31, 2015 |
|-------------------------------------------------------|--------------------|-------------------|
| Non-accrual loans                                     | \$ 6,889           | \$ 7,693          |
| Troubled debt restructuring                           | 999                | 1,060             |
| Loans past due 90 days or more and still accruing     | 80                 | 176               |
| Non-performing loans                                  | 7,968              | 8,929             |
| Foreclosed real estate                                | 5,042              | 4,541             |
| Non-performing assets                                 | \$ 13,010          | \$ 13,470         |
| Non-performing loans as a percentage of total loans   | 0.36%              | 0.44%             |
| Non-performing assets as a percentage of total assets | 0.44%              | 0.48%             |

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

| (in thousands)                                           | September 30, 2016 | December 31, 2015 |
|----------------------------------------------------------|--------------------|-------------------|
| <b>Non-accrual loans by type</b>                         |                    |                   |
| Commercial and industrial                                | \$ 2,177           | \$ 3,643          |
| Construction and development, excluding undeveloped land | 910                | -                 |
| Undeveloped land                                         | 655                | -                 |
| Real estate mortgage - commercial investment             | 94                 | 278               |
| Real estate mortgage - owner occupied commercial         | 1,548              | 2,761             |
| Real estate mortgage - 1-4 family residential            | 920                | 906               |
| Home equity and consumer loans                           | 585                | 105               |
| Total loans                                              | \$ 6,889           | \$ 7,693          |

## c) Liquidity

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

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

Bancorp's most liquid assets are comprised of cash and due from banks, available-for-sale marketable investment securities, federal funds sold and interest bearing deposits. Federal funds sold and interest bearing deposits totaled \$16.4 million at September 30, 2016. These investments normally have overnight maturities and are used for general daily liquidity purposes. The fair value of the available-for-sale investment portfolio was \$541.7 million at September 30, 2016. The portfolio includes maturities of approximately \$136.0 million over the next twelve months, including \$100 million of short-term securities which matured in October 2016. Combined with federal funds sold and interest bearing deposits, these offer substantial resources to meet either new loan demand or reductions in Bancorp's deposit funding base. Bancorp pledges portions of its investment securities portfolio to secure public fund deposits, cash balances of certain wealth management and trust accounts, and securities sold under agreements to repurchase. At September 30, 2016, total investment securities pledged for these purposes comprised 60% of the available-for-sale investment portfolio, leaving \$323.3 million of unpledged securities.

Bancorp has a large base of non-maturity customer deposits, defined as demand, savings, and money market deposit accounts. At September 30, 2016, such deposits totaled \$2.1 billion and represented 89.7% of Bancorp's total deposits. Because these deposits are less volatile and are often tied to other products of Bancorp through long lasting relationships they do not put heavy pressure on liquidity. However, many of Bancorp's customers' deposit balances are historically high. When market conditions improve, these balances will likely decrease, putting some strain on Bancorp's liquidity position. As of September 30, 2016, Bancorp had \$498 thousand or 0.02% of total deposits, in brokered deposits.

Included in the total deposit balances at September 30, 2016 is \$113.0 million of public funds deposits generally comprised of accounts from local government agencies and public school districts in our markets. As a result of property tax collections in the latter part of each year these accounts provide seasonal excess balances that originate with tax payments and decline leading into the next tax season. While this excess liquidity is maintained in low-yielding short-term investments and consequently results in lower net interest margin, it has a positive impact on net interest income.

Other sources of funds available to meet daily needs include FHLB advances. As a member of the FHLB of Cincinnati, Bancorp has access to credit products offered by the FHLB. Bancorp views these borrowings as a low cost alternative to other time deposits. At September 30, 2016, available credit from the FHLB totaled \$366.5 million. Additionally, Bancorp had available federal funds purchased lines with correspondent banks totaling \$80 million at September 30, 2016.

Bancorp's principal source of cash revenues is dividends paid to it as sole shareholder of the Bank. At September 30, 2016, the Bank may pay up to \$76.9 million in dividends to Bancorp without regulatory approval subject to the ongoing capital requirements of the Bank.

### **d) Capital Resources**

At September 30, 2016, stockholders' equity totaled \$311.6 million, an increase of \$25.1 million since December 31, 2015. See the Consolidated Statement of Changes in Stockholders' Equity for further detail of the changes in equity since the end of 2015. One component of equity is accumulated other comprehensive income which, for Bancorp, consists of net unrealized gains or losses on securities available-for-sale and hedging instruments, as well as a minimum pension liability, each net of taxes. Accumulated other comprehensive income was \$4.4 million at September 30, 2016 compared with \$632 thousand on December 31, 2015. The \$3.8 million increase is primarily a reflection of the positive effect of the changing interest rate environment during the first nine months of 2016 on the valuation of Bancorp's portfolio of securities available-for-sale.

# **STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

The following table sets forth Bancorp's and the Bank's risk based capital ratios as of September 30, 2016 and December 31, 2015.

|                                                    | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|----------------------------------------------------|-------------------------------|------------------------------|
| <b>Total risk-based capital (1)</b>                |                               |                              |
| Consolidated                                       | 13.05%                        | 13.31%                       |
| Bank                                               | 12.64                         | 12.91                        |
| <b>Common equity tier 1 risk-based capital (1)</b> |                               |                              |
| Consolidated                                       | 12.07                         | 12.32                        |
| Bank                                               | 11.66                         | 11.92                        |
| <b>Tier 1 risk-based capital (1)</b>               |                               |                              |
| Consolidated                                       | 12.07                         | 12.32                        |
| Bank                                               | 11.66                         | 11.92                        |
| <b>Leverage (2)</b>                                |                               |                              |
| Consolidated                                       | 10.63                         | 10.53                        |
| Bank                                               | <u>10.26</u>                  | <u>10.19</u>                 |

(1) Under the banking agencies risk-based capital guidelines, assets and credit-equivalent amounts of derivatives and off-balance sheet exposures are assigned to broad risk categories. The aggregate dollar amount in each risk category is multiplied by the associated risk weight of the category. The resulting weighted values are added together, resulting in the Bancorp's total risk-weighted assets. These ratios are computed in relation to average assets.

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

In 2013, the Federal Reserve Board and the FDIC approved rules that substantially amended the regulatory risk-based capital rules applicable to Bancorp and Bank. The rules implemented the regulatory capital reforms of the Basel Committee on Banking Supervision reflected in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III) and changes required by the Dodd-Frank Act. The Basel III regulatory capital reforms became effective for Bancorp and Bank on January 1, 2015, and included new minimum risk-based capital and leverage ratios. The minimum capital level requirements applicable to bank holding companies and banks subject to the rules are:

- a common equity tier 1 capital ratio of 4.5%,
- a tier 1 risk-based capital ratio of 6% (increased from 4%),
- a total risk-based capital ratio of 8% (unchanged from current rules), and
- a tier 1 leverage ratio of 4% for all institutions.

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

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

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

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

As of September 30, 2016, Bancorp meets the requirements to be considered well capitalized under the rules, and is not subject to limitations due to the capital conservation buffer.

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

In addition to capital ratios defined by banking regulators, Bancorp considers various ratios when evaluating capital adequacy and overhead, including tangible common equity to tangible assets, tangible common equity per share, and adjusted efficiency ratio, all of which are non-GAAP measures. Bancorp believes the tangible common equity ratios are important because of their widespread use by investors as means to evaluate capital adequacy, as they reflect the level of capital available to withstand unexpected market conditions. Because US GAAP does not include capital ratio measures, there are no US GAAP financial measures comparable to these ratios. In addition to the efficiency ratio normally presented, Bancorp considers an adjusted efficiency ratio. Bancorp believes excluding amortization of investments in tax credit partnerships from non-interest expense in this ratio is important because it provides a meaningful comparison to both prior periods, since amortization expense can fluctuate widely between periods depending upon timing of tax credits, and to other companies who do not invest in these partnerships.

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

| (in thousands, except per share data)      | September 30, 2016  | December 31, 2015   |
|--------------------------------------------|---------------------|---------------------|
| Total equity                               | \$ 311,570          | \$ 286,519          |
| Less core deposit intangible               | (1,453)             | (1,601)             |
| Less goodwill                              | (682)               | (682)               |
| Tangible common equity                     | <u>\$ 309,435</u>   | <u>\$ 284,236</u>   |
| Total assets                               | \$ 2,938,665        | \$ 2,816,801        |
| Less core deposit intangible               | (1,453)             | (1,601)             |
| Less goodwill                              | (682)               | (682)               |
| Total tangible assets                      | <u>\$ 2,936,530</u> | <u>\$ 2,814,518</u> |
| Total shareholders' equity to total assets | 10.60%              | 10.17%              |
| Tangible common equity ratio               | <u>10.54</u>        | <u>10.10</u>        |
| Number of outstanding shares               | <u>22,563</u>       | <u>22,379</u>       |
| Book value per share                       | \$ 13.81            | \$ 12.80            |
| Tangible common equity per share           | <u>13.71</u>        | <u>12.70</u>        |

# **STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

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

|                                                              | <b>Three months ended<br/>September 30,</b> |                  | <b>Nine months ended<br/>September 30,</b> |                  |
|--------------------------------------------------------------|---------------------------------------------|------------------|--------------------------------------------|------------------|
| (amounts in thousands)                                       | <b>2016</b>                                 | <b>2015</b>      | <b>2016</b>                                | <b>2015</b>      |
| Non-interest expense                                         | \$ 20,518                                   | \$ 18,430        | \$ 60,251                                  | \$ 55,076        |
| Net interest income (tax-equivalent)                         | 24,963                                      | 22,312           | 72,816                                     | 66,196           |
| Non-interest income                                          | 11,358                                      | 9,985            | 32,218                                     | 29,877           |
| Total revenue                                                | <u>\$ 36,321</u>                            | <u>\$ 32,297</u> | <u>\$ 105,034</u>                          | <u>\$ 96,073</u> |
| Efficiency ratio                                             | <u>56.5%</u>                                | <u>57.1%</u>     | <u>57.4%</u>                               | <u>57.3%</u>     |
| (amounts in thousands)                                       | <b>2016</b>                                 | <b>2015</b>      | <b>2016</b>                                | <b>2015</b>      |
| Non-interest expense                                         | \$ 20,518                                   | \$ 18,430        | \$ 60,251                                  | \$ 55,076        |
| Less: amortization of investments in tax credit partnerships | (1,015)                                     | (158)            | (3,046)                                    | (475)            |
| Adjusted non-interest expense                                | 19,503                                      | 18,272           | 57,205                                     | 54,601           |
| Net interest income (tax-equivalent)                         | 24,963                                      | 22,312           | 72,816                                     | 66,196           |
| Non-interest income                                          | 11,358                                      | 9,985            | 32,218                                     | 29,877           |
| Total revenue                                                | <u>\$ 36,321</u>                            | <u>\$ 32,297</u> | <u>\$ 105,034</u>                          | <u>\$ 96,073</u> |
| Adjusted efficiency ratio                                    | <u>53.7%</u>                                | <u>56.6%</u>     | <u>54.5%</u>                               | <u>56.8%</u>     |

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

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

In February 2016, FASB issued ASU No. 2016-02, *Leases*, which requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize on the balance sheet a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for lease term. The new guidance is effective for annual and interim reporting periods beginning after December 15, 2018. The amendment should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. Bancorp is evaluating the potential impact of adoption of ASU 2016-02.

## STOCK YARDS BANCORP, INC. AND SUBSIDIARY

In March 2016, FASB issued ASU No. 2016-09, *Compensation – Stock Compensation*. The new guidance simplifies certain aspects related to income taxes, statement of cash flows, and forfeitures when accounting for share-based payment transactions. The new guidance is effective for annual and interim reporting periods beginning after December 15, 2016. Certain of the amendments related to timing of the recognition of tax benefits and tax withholding requirements should be applied using a modified retrospective transition method. Amendments related to the presentation of the statement of cash flows should be applied retrospectively. All other provisions may be applied on a prospective or modified retrospective basis. After adoption of the ASU, Bancorp would record the excess tax benefits related to stock compensation as a component of income tax expense rather than additional paid-in capital. For the year ended December 31, 2015, the excess tax benefit recorded to additional paid-in capital was \$673 thousand. Bancorp is considering the potential impact of early adoption of ASU 2016-09.

In June 2016, FASB issued ASU 2016-13, *Measurement of Credit Losses on Financial Instruments*, which significantly changes the way entities recognize impairment of many financial assets by requiring immediate recognition of estimated credit losses expected to occur over their remaining life. The new guidance is effective for annual and interim reporting periods beginning after December 15, 2019. Bancorp is evaluating the potential impact of adoption of ASU 2016-13.

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

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

### Item 4. Controls and Procedures

Bancorp maintains disclosure controls and procedures designed to ensure that it is able to collect the information it is required to disclose in reports it files with the Securities and Exchange Commission ("SEC"), and to record, process, summarize and report this information within the time periods specified in the rules and forms of the SEC. Based on their evaluation of Bancorp's disclosure controls and procedures as of the end of the quarterly period covered by this report, the Chief Executive and Chief Financial Officers believe that these controls and procedures are effective to ensure that Bancorp is able to collect, process and disclose the information it is required to disclose in reports it files with the SEC within the required time periods.

Based on the evaluation of Bancorp's disclosure controls and procedures by the Chief Executive and Chief Financial Officers, there were no significant changes during the quarter ended September 30, 2016 in Bancorp's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, Bancorp's internal control over financial reporting.

# STOCK YARDS BANCORP, INC. AND SUBSIDIARY

## PART II – OTHER INFORMATION

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

The following table shows information relating to the repurchase of shares of common stock by Bancorp during the three months ended September 30, 2016.

|                  | <b>Total number of<br/>shares<br/>purchased (1)</b> | <b>Average price paid<br/>per share</b> | <b>Total number of<br/>shares purchased as<br/>part of publicly<br/>announced plan</b> | <b>Maximum number of<br/>shares that may yet be<br/>purchased under the<br/>plan</b> |
|------------------|-----------------------------------------------------|-----------------------------------------|----------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------|
| July 1 - July 31 | 7,371                                               | \$ 29.45                                | —                                                                                      | —                                                                                    |
| Aug 1 - Aug 31   | —                                                   | —                                       | —                                                                                      | —                                                                                    |
| Sept 1 - Sept 30 | 7,299                                               | 32.03                                   | —                                                                                      | —                                                                                    |
| Total            | 14,670                                              | \$ 30.73                                | —                                                                                      | —                                                                                    |

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

### Item 6. Exhibits

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

| <b>Exhibit<br/>Number</b> | <b>Description of exhibit</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|---------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1                      | Certifications pursuant to Section 302 of the Sarbanes-Oxley Act by David P. Heintzman                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| 31.2                      | Certifications pursuant to Section 302 of the Sarbanes-Oxley Act by Nancy B. Davis                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| 32                        | Certifications pursuant to 18 U.S.C. Section 1350                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| 101                       | The following financial statements from the Stock Yards Bancorp, Inc. September 30, 2016 Quarterly Report on Form 10-Q, filed on November 7, 2016, formatted in eXtensible Business Reporting Language (XBRL): <ul style="list-style-type: none"> <li>(1) Consolidated Balance Sheets</li> <li>(2) Consolidated Statements of Income</li> <li>(3) Consolidated Statements of Comprehensive Income</li> <li>(4) Consolidated Statements of Changes in Stockholders' Equity</li> <li>(5) Consolidated Statements of Cash Flows</li> <li>(6) Notes to Consolidated Financial Statements</li> </ul> |

**STOCK YARDS BANCORP, INC. AND SUBSIDIARY**

**SIGNATURES**

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

**STOCK YARDS BANCORP, INC.**

Date: November 7, 2016

By: /s/ David P. Heintzman

David P. Heintzman, Chairman  
and Chief Executive Officer

Date: November 7, 2016

By: /s/ Nancy B. Davis

Nancy B. Davis, Executive Vice President,  
Treasurer and Chief Financial Officer

**CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT**

I, David P. Heintzman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Stock Yards Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2016

By: /s/ David P. Heintzman

David P. Heintzman,  
Chairman and  
Chief Executive Officer

**CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT**

I, Nancy B. Davis, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Stock Yards Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2016

By: /s/ Nancy B. Davis  
Nancy B. Davis, Executive Vice  
President, Treasurer and Chief  
Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with this quarterly report of Stock Yards Bancorp, Inc. on Form 10-Q for the period ending September 30, 2016 (the "Report"), we, the undersigned, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of our knowledge and belief: (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Stock Yards Bancorp, Inc. as of and for the periods presented in the Report.

Date: November 7, 2016

By: /s/ David P. Heintzman

David P. Heintzman,  
Chairman and  
Chief Executive Officer

Date: November 7, 2016

By: /s/ Nancy B. Davis

Nancy B. Davis,  
Executive Vice President, Treasurer and  
Chief Financial Officer

**A signed original of this written statement required by section 906 has been provided to Stock Yards Bancorp, Inc. and will be retained by Stock Yards Bancorp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.**