

S&T BANCORP INC  
Form 10-Q  
November 05, 2008  
Table of Contents

## SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

### FORM 10-Q

*(Mark One)*

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

For the quarterly period ended September 30, 2008

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 0-12508

## S&T BANCORP, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: S&T BANCORP INC - Form 10-Q

**Pennsylvania**  
(State or other jurisdiction of  
incorporation or organization)

**25-1434426**  
(IRS Employer  
Identification No.)

**800 Philadelphia Street, Indiana, PA**  
(Address of principal executive offices)

**15701**  
(zip code)

**800-325-2265**

(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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition 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 Act). Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

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

Common Stock, \$2.50 Par Value - 27,594,416 shares as of October 24, 2008

**Table of Contents**

**INDEX**

**S&T BANCORP, INC. AND SUBSIDIARIES**

	<b>Page No.</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
Item 1. Financial Statements	
<u>Condensed consolidated balance sheets – September 30, 2008 and December 31, 2007</u>	3
<u>Condensed consolidated statements of income – Three and nine months ended September 30, 2008 and 2007</u>	4
<u>Condensed consolidated statements of changes in shareholders' equity – Nine months ended September 30, 2008 and 2007</u>	5
<u>Condensed consolidated statements of cash flows – Nine months ended September 30, 2008 and 2007</u>	6
<u>Notes to condensed consolidated financial statements</u>	7-18
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18-34
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	35-36
Item 4. <u>Controls and Procedures</u>	36-37
<b><u>PART II. OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	37
Item 1A. <u>Risk Factors</u>	37
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	37
Item 3. <u>Defaults Upon Senior Securities</u>	37
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	37
Item 5. <u>Other Information</u>	37
Item 6. <u>Exhibits</u>	37-38
<u>SIGNATURES</u>	39

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

<i>(dollars in thousands, except share and per share data)</i>	<b>September 30, 2008 (Unaudited)</b>	<b>December 31, 2007 (Audited)</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 67,872	\$ 74,879
Securities available for sale	467,579	358,822
Other investments	29,265	13,833
Loans held for sale	452	899
Portfolio loans, net of allowance for loan losses of \$43,235 at September 30, 2008 and \$34,345 at December 31, 2007	3,534,900	2,761,695
Premises and equipment, net	46,233	37,629
Goodwill	163,333	50,087
Other intangibles, net	12,318	2,461
Bank owned life insurance	50,754	35,626
Other assets	88,379	71,690
<b>Total Assets</b>	<b>\$ 4,461,085</b>	<b>\$ 3,407,621</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing demand	\$ 600,246	\$ 459,708
Interest-bearing demand	220,778	151,686
Money market	215,192	144,408
Savings	844,846	946,967
Time deposits	1,250,820	919,056
<b>Total Deposits</b>	<b>3,131,882</b>	<b>2,621,825</b>
Securities sold under repurchase agreements and federal funds purchased	174,656	100,258
Short-term borrowings	377,850	80,000
Long-term borrowings	190,302	201,021
Junior subordinated debt	90,619	25,000
Other liabilities	45,059	41,957
<b>Total Liabilities</b>	<b>4,010,368</b>	<b>3,070,061</b>
<b>SHAREHOLDERS EQUITY</b>		
Preferred stock, without par value, 10,000,000 shares authorized and none outstanding		
Common stock (\$2.50 par value) Authorized 50,000,000 shares in 2008 and 2007 Issued 29,714,038 shares in 2008 and 2007	74,285	74,285
Additional paid-in capital	43,139	27,502
Retained earnings	395,367	375,654
Accumulated other comprehensive (loss) income	(3,305)	2,900
Treasury stock (2,125,528 shares at September 30, 2008 and 5,162,951 shares at December 31, 2007, at cost)	(58,769)	(142,781)
<b>Total Shareholders Equity</b>	<b>450,717</b>	<b>337,560</b>
<b>Total Liabilities and Shareholders Equity</b>	<b>\$ 4,461,085</b>	<b>\$ 3,407,621</b>

See notes to Condensed Consolidated Financial Statements



**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<i>(dollars and share data in thousands, except per share data)</i>				
<b>INTEREST INCOME</b>				
Loans, including fees	\$ 52,630	\$ 50,738	\$ 145,951	\$ 149,625
Deposits with banks and federal funds sold	2	28	3	33
Investment securities:				
Taxable	3,503	2,935	8,909	8,999
Tax-exempt	1,076	651	2,465	1,961
Dividends	205	409	979	1,351
<b>Total Interest Income</b>	<b>57,416</b>	<b>54,761</b>	<b>158,307</b>	<b>161,969</b>
<b>INTEREST EXPENSE</b>				
Deposits	12,281	20,801	39,484	60,357
Securities sold under repurchase agreements and federal funds purchased	669	925	1,504	3,385
Short-term borrowings	1,680	379	3,684	1,966
Long-term borrowings and junior subordinated debt securities	3,615	3,380	10,273	9,824
<b>Total Interest Expense</b>	<b>18,245</b>	<b>25,485</b>	<b>54,945</b>	<b>75,532</b>
<b>NET INTEREST INCOME</b>	<b>39,171</b>	<b>29,276</b>	<b>103,362</b>	<b>86,437</b>
Provision for loan losses	6,156	1,142	7,317	4,625
<b>Net Interest Income After Provision for Loan Losses</b>	<b>33,015</b>	<b>28,134</b>	<b>96,045</b>	<b>81,812</b>
<b>NONINTEREST INCOME</b>				
Security (losses) gains, net	(341)	1,129	(1,559)	3,265
Service charges on deposit accounts	3,599	2,605	8,755	7,477
Wealth management fees	2,118	1,751	5,887	5,585
Letter of credit fees	343	421	1,318	1,568
Insurance commissions	2,073	1,874	6,112	5,559
Mortgage banking	380	244	572	613
Other	2,088	3,605	6,659	7,257
<b>Total Noninterest Income</b>	<b>10,260</b>	<b>11,629</b>	<b>27,744</b>	<b>31,324</b>
<b>NONINTEREST EXPENSE</b>				
Salaries and employee benefits	11,725	9,910	32,298	29,917
Occupancy, net	1,578	1,427	4,814	4,375
Furniture and equipment	1,183	996	3,243	2,756
Other taxes	677	583	2,119	2,123
Data processing	1,365	1,179	4,104	3,714
Marketing	799	549	2,461	1,810
Amortization of intangibles	358	71	655	233
FDIC assessment	131	74	280	227
Other	4,524	3,340	12,704	8,624
<b>Total Noninterest Expense</b>	<b>22,340</b>	<b>18,129</b>	<b>62,678</b>	<b>53,779</b>
<b>Income Before Taxes</b>	<b>20,935</b>	<b>21,634</b>	<b>61,111</b>	<b>59,357</b>
Provision for Income Taxes	5,249	5,973	16,708	16,524

Edgar Filing: S&T BANCORP INC - Form 10-Q

<b>Net Income</b>		<b>\$ 15,686</b>	<b>\$ 15,661</b>	<b>\$ 44,403</b>	<b>\$ 42,833</b>
<b>Earnings per common share:</b>					
Net Income Basic		\$ 0.57	\$ 0.64	\$ 1.72	\$ 1.73
Net Income Diluted		0.57	0.63	1.71	1.72
Dividends declared per common share		0.31	0.30	0.93	0.90
Average Common Shares Outstanding Basic		27,417	24,529	25,764	24,798
Average Common Shares Outstanding Diluted		27,602	24,691	25,935	24,960
See notes to Condensed Consolidated Financial Statements					

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)**

<i>(in thousands, except share and per share data)</i>	Comprehensive Income	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
<b>Balance at January 1, 2007</b>		<b>\$ 74,285</b>	<b>\$ 26,698</b>	<b>\$ 349,447</b>	<b>\$ 4,014</b>	<b>\$ (115,393)</b>	<b>\$ 339,051</b>
Net income for nine months ended September 30, 2007	\$ 42,833			42,833			42,833
<b>Other comprehensive income, net of tax</b>							
Change in unrealized losses on securities of \$2,303 net of reclassification adjustment for gains included in net income of \$3,265 and reclassification adjustment of \$1,606 related to Rabbi Trust and tax benefit of (\$2,876)	(4,298)				(4,298)		(4,298)
<b>Comprehensive Income</b>	<b>\$ 38,535</b>						
Cash dividends declared (\$0.90 per share)				(22,176)			(22,176)
Treasury stock acquired (971,400 shares)						(31,802)	(31,802)
Treasury stock issued for stock options exercised (153,303 shares)			(843)			4,195	3,352
Recognition of restricted stock compensation expense			116				116
Tax benefit from nonstatutory stock options exercised			596				596
Recognition of nonstatutory stock option compensation expense			341				341
Adjustment to initially apply FIN 48				(150)			(150)
<b>Balance at September 30, 2007</b>		<b>\$ 74,285</b>	<b>\$ 26,908</b>	<b>\$ 369,954</b>	<b>(\$ 284)</b>	<b>\$ (143,000)</b>	<b>\$ 327,863</b>
<b>Balance at January 1, 2008</b>		<b>\$ 74,285</b>	<b>\$ 27,502</b>	<b>\$ 375,654</b>	<b>\$ 2,900</b>	<b>\$ (142,781)</b>	<b>\$ 337,560</b>
Net income for nine months ended September 30, 2008	\$ 44,403			44,403			44,403
<b>Other comprehensive income, net of tax</b>							
Change in unrealized losses on securities of \$11,121 net of reclassification adjustment for losses included in net income of (\$1,559) and tax benefit of (\$3,347).	(6,215)				(6,215)		(6,215)
Change in pension obligation	10				10		10
<b>Comprehensive Income</b>	<b>\$ 38,198</b>						
Cash dividends declared (\$0.93 per share)				(24,690)			(24,690)
Treasury stock issued (285,674 shares)			(1,396)			7,899	6,503
Recognition of restricted stock compensation expense			286				286
Tax benefit from nonstatutory stock options exercised			804				804
Recognition of nonstatutory stock option compensation expense			341				341



Edgar Filing: S&T BANCORP INC - Form 10-Q

Treasury stock issued in acquisition (2,751,749 shares)		15,602			76,113	91,715
<b>Balance at September 30, 2008</b>	<b>\$ 74,285</b>	<b>\$ 43,139</b>	<b>\$ 395,367</b>	<b>\$ (3,305)</b>	<b>\$ (58,769)</b>	<b>\$ 450,717</b>

See Notes to Condensed Consolidated Financial Statements

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

<i>(dollars in thousands)</i>	<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating Activities</b>		
Net Income	\$ 44,403	\$ 42,833
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	7,317	4,625
Depreciation and amortization	3,549	2,788
Net amortization of investment security premiums	697	640
Recognition of stock-based compensation expense	1,148	553
Security losses (gains), net	1,559	(3,265)
Deferred income taxes	(5,858)	67
Tax benefits from stock-based compensation	(776)	(204)
Mortgage loans originated for sale	(13,769)	(13,173)
Proceeds from the sale of loans	14,394	12,964
Gain on the sale of loans, net	(178)	(300)
Increase in interest receivable	(6,122)	(659)
Increase in interest payable	80	1,157
Increase (decrease) in other assets	7,084	(4,286)
(Increase) decrease in other liabilities	(2,794)	4,244
<b>Net Cash Provided by Operating Activities</b>	<b>50,734</b>	<b>47,984</b>
<b>Investing Activities</b>		
Net increase of interest-earning deposits with banks	(12)	
Proceeds from maturities of securities available for sale	50,247	67,562
Proceeds from sales of securities available for sale	146,279	5,441
Purchases of securities available for sale	(73,331)	(8,489)
Net increase in loans	(294,662)	(88,465)
Purchases of premises and equipment	(4,047)	(4,118)
Payment for purchase of IBT, net of cash acquired	(68,304)	
<b>Net Cash Used in Investing Activities</b>	<b>(243,830)</b>	<b>(28,069)</b>
<b>Financing Activities</b>		
Net (decrease) increase in core deposits	(114,764)	42,540
Net increase in time deposits	51,221	12,329
Net increase (decrease) in short-term borrowings	297,850	(25,000)
Net decrease in securities sold under repurchase agreements and federal funds purchased	(28,940)	(37,212)
Proceeds from long-term borrowings	20,000	50,000
Repayments of long-term borrowings	(87,698)	(10,686)
Proceeds from junior subordinated debt securities	64,888	
Acquisition of treasury stock		(31,802)
Treasury stock issued for stock option exercises	6,503	3,352
Cash dividends paid to shareholders	(23,747)	(22,428)
Tax benefits from stock-based compensation	776	204
<b>Net Cash Provided (Used) by Financing Activities</b>	<b>186,089</b>	<b>(18,703)</b>
(Decrease) increase in Cash and Cash Equivalents	(7,007)	1,212
Cash and Cash Equivalents at Beginning of Period	74,879	59,980
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 67,872</b>	<b>\$ 61,192</b>

Edgar Filing: S&T BANCORP INC - Form 10-Q

**Non Cash Activities**

Transfers to other real estate owned	\$ 623	\$ 346
Net assets acquired in acquisition, excluding cash and cash equivalents	160,019	
See Notes to Condensed Consolidated Financial Statements		

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****NOTE A BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements of S&T Bancorp, Inc. and subsidiaries ( S&T ) have been prepared in accordance with generally accepted accounting principles ( GAAP ) in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete annual financial statements. In the opinion of management, all adjustments consisting of normal recurring accruals considered necessary for a fair presentation have been included. Operating results for the nine-month period ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. S&T operates within one business segment, community banking, providing a full range of services to individual and corporate customers. The condensed consolidated balance sheet as of December 31, 2007 has been extracted from the audited financial statements included in S&T 's 2007 Annual Report to Shareholders. For further information, refer to the consolidated financial statements and footnotes thereto included in the annual report on Form 10-K for the year ended December 31, 2007, as filed with the Securities and Exchange Commission ( SEC ) on February 29, 2008.

The financial statements of S&T have been prepared in accordance with GAAP. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the balance sheets and revenues and expenses for the periods. Actual results could differ from those estimates.

The consolidated financial statements include the accounts of S&T and its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation. Investments of 20 percent – 50 percent of the outstanding common stock of investees are accounted for using the equity method of accounting.

For the nine month periods ended September 30, 2008 and 2007, interest paid was \$44,636,000 and \$78,148,000, respectively. Income taxes paid during the first nine months of 2008 were \$17,928,000 compared to \$15,058,000 for the same period of 2007.

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation. The reclassifications had no effect on S&T 's financial condition or results of operations.

**NOTE B NET INCOME PER SHARE**

S&T 's basic net income per share is calculated as net income divided by the weighted average number of shares outstanding. For diluted net income per share, net income is divided by the weighted average number of shares outstanding plus the incremental number of shares added as a result of converting common stock equivalents, calculated using the treasury stock method. S&T 's common stock equivalents consist of outstanding stock options and restricted stock. Excluded from the calculation were anti-dilutive stock options for 551,000 and 564,000 shares for the nine months ended September 30, 2008 and 2007, respectively.

A reconciliation of the weighted average shares outstanding used to calculate basic net income per share and diluted net income per share follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Weighted average shares outstanding (basic)	27,416,807	24,529,448	25,764,275	24,798,043
Impact of common stock equivalents	185,409	161,287	170,370	161,521
<b>Weighted average shares outstanding (diluted)</b>	<b>27,602,216</b>	<b>24,690,735</b>	<b>25,934,645</b>	<b>24,959,564</b>

**NOTE C RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

## Edgar Filing: S&T BANCORP INC - Form 10-Q

In September 2006, the Financial Account Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements. SFAS No. 157 provides enhanced guidance for using fair value to measure assets and liabilities. SFAS No. 157 also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value.

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

measurements on earnings. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. SFAS No. 157 does not expand the use of fair value in any new circumstances. S&T adopted SFAS No. 157 as of January 1, 2008. The adoption of SFAS No. 157 did not have a significant impact on S&T's financial position or results of operations.

In February 2007, FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which is effective as of the beginning of the entity's first fiscal year that begins after November 15, 2007. SFAS No. 159 enables entities to reduce the volatility in reported earnings caused by measuring related assets and liabilities differently. SFAS No. 159 is expected to expand the use of fair-value measurements and achieve a long-term objective of reporting all financial instruments at fair value. S&T elected to not expand the use of fair value under SFAS No. 159.

In December 2007, FASB issued SFAS No. 141R, *Business Combinations*, and SFAS No. 160, *Noncontrolling Interest in Consolidated Financial Statements*. SFAS Nos. 141R and 160 require most identifiable assets, liabilities, noncontrolling interest, and goodwill acquired in a business combination to be recorded at full fair value and require noncontrolling interests (previously referred to as minority interests) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. SFAS Nos. 141R and 160 are effective for periods beginning on or after December 15, 2008, and earlier adoption is prohibited. SFAS No. 141R will be applied to all business entities and SFAS No. 160 will be applied prospectively to all noncontrolling interests, including any that arose before the December 15, 2008 effective date. S&T is in the process of determining the impact of applying SFAS Nos. 141R and 160 on S&T's financial position and results of operations.

**NOTE D ACQUISITION**

On June 6, 2008, S&T completed the acquisition of 100 percent of the voting shares of IBT Bancorp, Inc. located in Irwin, Pennsylvania, (IBT) which was the sole shareholder of Irwin Bank, in a stock and cash transaction valued at approximately \$177.1 million. Pursuant to the terms of the merger agreement, shareholders of IBT were entitled to elect to receive for each share of IBT common stock that they owned, either \$31.00 in cash or 0.93 of a share of S&T common stock. S&T issued 2,751,749 shares of common stock out of its treasury shares at a recorded fair value of \$91.7 million based on \$33.33 per share which was the closing price on May 12, 2008, the day before the IBT shareholders approved the merger and paid a total of \$75.1 million in cash to the former IBT shareholders. The acquisition significantly expands S&T's market share in the growing Allegheny and Westmoreland County markets in Western Pennsylvania. The acquisition was accounted for under the purchase method, and all transactions of IBT since the acquisition date are included in S&T's consolidated financial statements.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition of IBT. However, there may be additional adjustments through June 2009 as additional information becomes available.

<i>(dollars in thousands)</i>	<b>June 7, 2008</b>
	<b>Unaudited</b>
<b>Assets</b>	
Cash and cash equivalents	\$ 17,066
Securities	253,347
Other investments	5,856
Loans, net of allowance of \$5,420	485,860
Premises and other equipment	7,451
Goodwill and other intangibles	123,246
Other assets	23,962
<b>Total assets acquired</b>	<b>\$ 916,788</b>
<b>Liabilities</b>	
Deposits	\$ 573,601

Edgar Filing: S&T BANCORP INC - Form 10-Q

Borrowings	160,316
Other liabilities	5,786
<b>Total liabilities assumed</b>	<b>739,703</b>
<b>Net assets acquired</b>	<b>\$ 177,085</b>

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

Presented below is certain unaudited pro forma information for the nine months ended September 30, 2008 and 2007, as if IBT had been acquired on January 1, 2008 and 2007, respectively. These results combine the historical results of IBT for the period from January 1, 2008 to June 6, 2008 and for the nine months ended September 30, 2007 with the results of S&T. The results of IBT exclude certain non-recurring merger related expenses (including contract buy-outs, \$5,183; change-in-control payments, \$1,014; and legal and consulting expense, \$2,244). These pro forma results which include certain adjustments for the estimated impact of purchase accounting adjustments, are not necessarily indicative of what results would have been had the acquisition taken place on the indicated dates.

<i>(dollars in thousands)</i>	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Revenue	\$ 144,001	\$ 132,080
Net income	49,649	45,150
Basic EPS	\$ 1.82	\$ 1.64
Diluted EPS	\$ 1.80	\$ 1.63

**NOTE E FAIR VALUE**

Effective January 1, 2008, S&T adopted SFAS No. 157, Fair Value Measurements. SFAS No. 157 provides enhanced guidance for using fair value to measure assets and liabilities. SFAS No. 157 also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. SFAS No. 157 does not expand the use of fair value in any new circumstances.

**Fair-Value Hierarchy**

SFAS No. 157 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable.

Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect S&T's market assumptions. These two types of inputs have created the following fair-value hierarchy:

Level 1 Quoted prices for *identical* instruments in active markets.

Level 2 Quoted prices for *similar* instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are *unobservable*.

SFAS No. 157 requires the use of observable market data when available.

**Determination of Fair Value**

S&T measures fair value using the procedures set out below for all assets and liabilities measured at fair value.

When available, S&T generally uses quoted market prices to determine fair value, and classifies such items in Level 1. In some cases where a market price is available, S&T will make use of acceptable practical expedients (such as matrix pricing) to calculate fair value, in which case the items are classified in Level 2.



## Edgar Filing: S&T BANCORP INC - Form 10-Q

If quoted market prices are not available, fair value is based upon internal valuation techniques that use, where possible, current market-based or independently sourced market parameters, such as interest rates. Items valued using such valuation techniques are classified according to the lowest level input or value driver that is significant to the valuation. Thus, an item may be classified in Level 3 even though there may be some significant inputs that are readily observable.

---

**Table of Contents**

**S&T BANCORP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

The following section describes the valuation methodologies used by S&T to measure different financial instruments at fair value, including an indication of the level in the fair value hierarchy in which each instrument is generally classified. Where appropriate, the description includes details of the valuation models, the key inputs to those models, as well as any significant assumptions.

**Investments**

The investments category includes available for sale debt and equity securities, whose fair value is determined using the following methodology:

**Debt Securities** S&T obtains market values for debt securities from a third-party pricing service which utilizes several sources for valuing fixed-income securities. The majority of the market evaluation sources includes observable inputs rather than significant unobservable inputs and therefore falls into the Level 2 category.

S&T's U.S. government agencies and mortgage backed securities portfolio are valued based on market data. The service provider utilizes evaluated pricing models that vary based by asset class and include available trade, bid, and other market information. Generally, the methodologies include broker quotes, proprietary models, vast descriptive terms and conditions databases, as well as extensive quality control programs and are classified as Level 2.

S&T's obligations of state and political subdivisions portfolio is valued using proprietary valuation matrices from the service provider, which incorporates the recent unprecedented changes in the municipal market. The market evaluation model includes a separate curve structure for the bank-qualified versus general market municipals. For the bank-qualified municipals, the source is the service provider's own trading desk. Securities are further broken down according to insurer, credit support, state of issuance, and rating to incorporate additional spreads and municipal curves and are classified as Level 2.

**Equity Securities** Equity securities that have an active, quotable market are classified in Level 1. Equity securities that are quotable, but are thinly traded, are classified in Level 2, and securities that are not readily traded and do not have a quotable market are classified as Level 3.

**Trading Assets**

When available, S&T uses quoted market prices to determine the fair value of trading assets; such items are classified in Level 1 of the fair-value hierarchy. Since S&T's only trading account asset is a Rabbi Trust for deferred compensation plans, which is invested in two readily quoted mutual funds, the Rabbi Trust asset is classified as Level 1 and is recorded in other assets in S&T's Consolidated Balance Sheet.

**Impaired Loans**

A loan is considered to be impaired when it is probable that all of the principal and interest due under the original terms of the loan may not be collected. S&T's policy for impairment includes commercial and commercial real estate loans greater than \$500,000 for which a specific reserve has been established as a component of the allowance for loan losses. Impairment is measured based on the fair value of the underlying collateral. When the fair value is based on an observable market price or a current appraisal, impaired loans are classified as Level 2. When a current appraisal is not available, or if management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the impaired loans are classified as Level 3. Impaired loans are recorded in portfolio loans in S&T's Consolidated Balance Sheet.

**Mortgage Servicing Rights**

On January 1, 2007, S&T adopted fair-value accounting under SFAS No. 156 Accounting for Servicing of Financial Assets, for mortgage servicing rights (MSRs). The market value of the MSRs are estimated by calculating the present value of estimated future net servicing cash flows, taking into consideration actual and expected mortgage loan prepayment rates, discount rates, servicing costs and other economic factors, which are determined based on current market conditions. The expected and actual rates of mortgage loan prepayments are the most significant factors driving the value of MSRs.



**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

These MSRs, which totaled \$1,867,000 as of September 30, 2008, are classified as part of other assets on S&T's Consolidated Balance Sheet. Changes in fair value for MSRs are recorded in mortgage banking in S&T's Consolidated Statements of Income. MSRs are classified as Level 3 because the valuation model includes significant unobservable inputs.

**Interest Rate Swaps**

S&T has certain interest rate derivative positions that are not designated as hedging instruments. These derivative positions relate to transactions in which S&T enters into an interest-rate swap with a customer while at the same time entering into an offsetting interest-rate swap with another financial institution. In connection with each transaction, S&T agrees to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on the same notional amount at a fixed rate. At the same time, S&T agrees to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows S&T to provide long-term fixed rate financing to the customer while retaining a variable rate asset on the balance sheet. Because S&T has two offsetting swaps, changes in the market value of the underlying derivative contracts largely offset each other and do not materially impact S&T's results of operations.

These interest rate swaps are marked to market on a quarterly basis after considerations of counterparty and S&T credit risk and collateral. Because the estimated fair market value includes certain observable inputs, it is considered a Level 2 fair value.

**Items Measured at Fair Value on a Recurring Basis**

The following table presents S&T's assets and liabilities that are measured at fair value on a recurring basis by fair value hierarchy level at September 30, 2008.

<i>(dollars in thousands)</i>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets</b>				
Securities available for sale	\$ 8,473	\$ 458,056	\$ 1,050	\$ 467,579
Impaired Loans		31,912	13,959	45,871
Trading account assets	2,922			2,922
Mortgage servicing rights			1,867	1,867
Interest rate swaps		5,742		5,742
<b>Total Assets</b>	<b>\$ 11,395</b>	<b>\$ 495,710</b>	<b>\$ 16,876</b>	<b>\$ 523,981</b>
<b>Liabilities</b>				
Interest rate swaps		\$ 5,995		\$ 5,995
<b>Total Liabilities</b>		<b>\$ 5,995</b>		<b>\$ 5,995</b>

**Loans Originated for Sale and Held For Sale**

Loans held for sale consist of 1-4 family residential loans originated for sale in the secondary market and carried at the lower of cost or fair value. As a result, the carrying amount of loans held for sale has not been included in the disclosure of fair value hierarchy in the table above. S&T determines fair value based on reference to quoted market prices for similar assets and liabilities. As a result, such estimates of fair value would be considered a Level 2 disclosure.



**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

The following table presents the changes in the Level 3 fair-value category for the nine-month period ended September 30, 2008. S&T classifies financial instruments in Level 3 of the fair-value hierarchy when there is reliance on at least one significant unobservable input to the valuation model. In addition to these unobservable inputs, the valuation models for Level 3 financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Thus, the gains and losses presented below include changes in the fair value related to both observable and unobservable inputs.

<i>(dollars in thousands)</i>	Beginning Balance at January 1, 2008	Principal Transactions	Gains/(Losses) Realized and Unrealized	Transfers in and or out of Level 3	Ending Balance at September 30, 2008
<b>Assets</b>					
Securities available for sale <sup>(1)</sup>	\$ 750	\$ 300	\$	\$	\$ 1,050
Impaired Loans <sup>(2)</sup>	9,498	4,471			13,959
Mortgage servicing rights <sup>(3)</sup>	1,861	(75)	81		1,867

<sup>(1)</sup> Changes in fair value for available for sale investments are recorded in accumulated other comprehensive income, while gains and losses from sales are recorded in net security gains(losses) on the Condensed Consolidated Statements of Income.

<sup>(2)</sup> Changes in fair value of the underlying collateral on impaired loans are recorded in provision for loans losses on the Condensed Consolidated Statements of Income.

<sup>(3)</sup> Unrealized gains (losses) on MSR's are recorded in mortgage banking noninterest income on the Condensed Consolidated Statements of Income.

**NOTE F MORTGAGE LOAN SERVICING**

Mortgage servicing assets are recognized as separate assets when servicing rights are acquired through loan originations and the underlying loan is sold. Upon sale, the mortgage servicing right is established, which represents the then fair value of future net cash flows expected to be realized for performing the servicing activities. The fair value of the MSR's are estimated by calculating the present value of estimated future net servicing cash flows, taking into consideration actual and expected mortgage loan prepayment rates, discount rates, servicing costs and other economic factors, which are determined based on current market conditions. The expected and actual rates of mortgage loan prepayments are the most significant factors driving the value of MSR's. Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced. In determining the fair value of the MSR's, mortgage interest rates, which are used to determine prepayment rates and discount rates, are held constant over the estimated life of the portfolio. Capitalized MSR's are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying mortgage loans.

Capitalized MSR's are regularly evaluated for impairment based on the estimated fair value of those rights. The MSR's are stratified by certain risk characteristics, primarily loan term and note rate. If temporary impairment exists within a risk stratification tranche, a valuation allowance is established through a charge to income equal to the amount by which the carrying value exceeds the market value. If it is later determined all or a portion of the temporary impairment no longer exists for a particular tranche, the valuation allowance is reduced.

MSR's are also reviewed for other-than-temporary impairment. Other-than-temporary impairment exists when the recoverability of a recorded valuation allowance is determined to be remote, taking into consideration historical and projected interest rates and loan pay-off activity. When this situation occurs, the unrecoverable portion of the valuation allowance is applied as a direct write-down to the carrying value of the MSR's. Unlike a valuation allowance, a direct write-down permanently reduces the carrying value of the MSR's and the valuation allowance, precluding subsequent recoveries.

## Edgar Filing: S&T BANCORP INC - Form 10-Q

For the nine months ended September 30, 2008 and 2007, the 1-4 family mortgage loans that were sold to Fannie Mae amounted to \$14.4 million and \$13.0 million, respectively. At September 30, 2008 and 2007, S&T's servicing portfolio totaled \$174.5 million and \$178.3 million, respectively.

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

The following table presents changes in MSR as of and for the nine months ended September 30, 2008 and 2007:

	Servicing Rights	Valuation Allowance	Net Carrying Value and Fair Value
<i>(dollars in thousands)</i>			
<b>Balance at January 1, 2008</b>	<b>\$ 2,017</b>	<b>\$ 156</b>	<b>\$ 1,861</b>
Additions/(reductions)	179	(85)	264
Amortization	(258)		(258)
<b>Balance at September 30, 2008</b>	<b>\$ 1,938</b>	<b>\$ 71</b>	<b>\$ 1,867</b>

	Servicing Rights	Valuation Allowance	Net Carrying Value and Fair Value
<i>(dollars in thousands)</i>			
<b>Balance at January 1, 2007</b>	<b>\$ 2,124</b>	<b>\$ 56</b>	<b>\$ 2,068</b>
Additions/(reductions)	170	(35)	205
Amortization	(244)		(244)
<b>Balance at September 30, 2007</b>	<b>\$ 2,050</b>	<b>\$ 21</b>	<b>\$ 2,029</b>

**NOTE G EMPLOYEE BENEFITS**

The following table summarizes the components of net periodic pension expense for S&T's defined benefit plan:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
<i>(dollars in thousands)</i>				
Service cost – benefits earned during the period	\$ 531	\$ 489	\$ 1,496	\$ 1,491
Interest cost on projected benefit obligation	884	756	2,533	2,236
Expected return on plan assets	(1,387)	(1,231)	(4,010)	(3,698)
Net amortization and deferral	(1)	4	7	12
<b>Net Periodic Pension Expense</b>	<b>\$ 27</b>	<b>\$ 18</b>	<b>\$ 26</b>	<b>\$ 41</b>

As previously disclosed, S&T made no contributions to its pension plan in 2008. No contributions are expected to be made for 2008.



**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued****NOTE H SECURITIES**

The amortized cost and market value of securities are as follows:

**September 30, 2008**

<i>(dollars in thousands)</i>	Amortized Cost	Available for Sale		Market Value
		Gross Unrealized Gains	Gross Unrealized Losses	
Obligations of U.S. government corporations and agencies	\$ 190,700	\$ 1,357	\$ (58)	\$ 191,999
Collateralized mortgage obligations of U.S. government corporations and agencies	53,801	350	(50)	54,101
Mortgage-backed securities	79,027	278	(352)	78,953
Obligations of state and political subdivisions	125,477	193	(2,566)	123,104
Other securities	25			25
<b>Debt securities available for sale</b>	<b>449,030</b>	<b>2,178</b>	<b>(3,026)</b>	<b>448,182</b>
Marketable equity securities	19,518	1,427	(1,726)	19,219
Other securities	178			178
<b>Total</b>	<b>\$ 468,726</b>	<b>\$ 3,605</b>	<b>\$ (4,752)</b>	<b>\$ 467,579</b>

**December 31, 2007**

<i>(dollars in thousands)</i>	Amortized Cost	Available for Sale		Market Value
		Gross Unrealized Gains	Gross Unrealized Losses	
Obligations of U.S. government corporations and agencies	\$ 144,230	\$ 1,220	\$ (128)	\$ 145,322
Collateralized mortgage obligations of U.S. government corporations and agencies	58,780	377	(161)	58,996
Mortgage-backed securities	28,053	21	(502)	27,572
Obligations of state and political subdivisions	81,045	253	(209)	81,089
<b>Debt securities available for sale</b>	<b>312,108</b>	<b>1,871</b>	<b>(1,000)</b>	<b>312,979</b>
Marketable equity securities	33,767	10,134	(2,590)	41,311
Other securities	4,532			4,532
<b>Total</b>	<b>\$ 350,407</b>	<b>\$ 12,005</b>	<b>\$ (3,590)</b>	<b>\$ 358,822</b>

For securities classified as available for sale, S&T does not believe any individual unrealized loss as of September 30, 2008 represents an other-than-temporary impairment. S&T performs a review of the entire securities portfolio on a quarterly basis to identify securities that may indicate an other-than-temporary impairment. S&T management considers the length of time and the extent to which the market value has been less than cost and the financial condition of the issuer. The unrealized losses on 202 debt securities at September 30, 2008 are attributable to changes in interest rates. The unrealized losses on 11 marketable equity securities at September 30, 2008 are attributable to temporary declines in market value. S&T has both the intent and the ability to hold the securities referenced in the table above for a time necessary to recover the amortized cost or, in the case of the debt securities, until maturity.



**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

There were \$3.1 million and \$3.4 million in gross realized gains and \$4.6 million and \$0.1 million in gross realized losses for the nine months ended September 30, 2008 and 2007, respectively, relative to securities available for sale. S&T recognized other-than-temporary impairments totaling \$3.9 million on five equity securities and \$0.7 million of realized losses from restructuring the IBT debt securities during the first nine months of 2008 and a \$0.1 million of other-than temporary impairment on one equity security during the nine months ended September 30, 2007, which are included in the gross unrealized losses. For the three months ended September 30, 2008 and 2007, there were \$2.2 million and \$1.1 million in gross realized gains and \$2.6 million and zero gross realized losses, respectively, relative to securities available for sale. For the three months ended September 30, 2008, S&T recognized other-than-temporary impairments of \$2.6 million on two equity securities and had no other-than-temporary impairment for the three months ended September 30, 2007.

The following tables present the age of gross unrealized losses and market value by investment category:

**September 30, 2008**

<i>(dollars in thousands)</i>	Less Than 12 Months		12 Months or More		Total	
	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
Obligations of U.S. government corporations and agencies	\$ 25,033	\$ (58)	\$	\$	\$ 25,033	\$ (58)
Collateralized mortgage obligations of U.S. government corporations and agencies	12,301	(50)			12,301	(50)
Mortgage-backed securities	16,315	(83)	9,791	(269)	26,106	(352)
Obligations of state and political subdivisions	79,441	(2,564)	364	(2)	79,805	(2,566)
<b>Debt securities available for sale</b>	<b>133,090</b>	<b>(2,755)</b>	<b>10,155</b>	<b>(271)</b>	<b>143,245</b>	<b>(3,026)</b>
Marketable equity securities	5,597	(1,726)			5,597	(1,726)
<b>Total temporarily impaired securities</b>	<b>\$ 138,687</b>	<b>\$ (4,481)</b>	<b>\$ 10,155</b>	<b>\$ (271)</b>	<b>\$ 148,842</b>	<b>\$ (4,752)</b>

**December 31, 2007**

<i>(dollars in thousands)</i>	Less Than 12 Months		12 Months or More		Total	
	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
Obligations of U.S. government corporations and agencies	\$	\$	\$ 43,378	\$ (128)	\$ 43,378	\$ (128)
Collateralized mortgage obligations of U.S. government corporations and agencies	12,513	(37)	15,076	(124)	27,589	(161)
Mortgage-backed securities			21,420	(502)	21,420	(502)
Obligations of state and political subdivisions			43,087	(209)	43,087	(209)
<b>Debt securities available for sale</b>	<b>12,513</b>	<b>(37)</b>	<b>122,961</b>	<b>(963)</b>	<b>135,474</b>	<b>(1,000)</b>
Marketable equity securities	15,545	(2,590)			15,545	(2,590)
<b>Total temporarily impaired securities</b>	<b>\$ 28,058</b>	<b>\$ (2,627)</b>	<b>\$ 122,961</b>	<b>\$ (963)</b>	<b>\$ 151,019</b>	<b>\$ (3,590)</b>

The amortized cost and estimated market value of debt securities at September 30, 2008, by expected maturity, are as set forth in the following table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or

without call or prepayment penalties.

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

For purposes of the maturity table, mortgage-backed securities and collateralized mortgage obligations, which are not due at a single maturity date, have been allocated over maturity groupings based upon the current estimated prepayment rates. The mortgage-backed securities and collateralized mortgage obligations may mature earlier or later than their estimated maturities because of principal repayment optionality.

**Available for Sale**

<i>(dollars in thousands)</i>	<b>Amortized Cost</b>	<b>Estimated Market Value</b>
Due in one year or less	\$ 75,941	\$ 76,201
Due after one year through five years	155,974	156,932
Due after five years through ten years	111,485	111,193
Due after ten years	105,630	103,856
<b>Total Debt Securities Available for Sale</b>	<b>\$ 449,030</b>	<b>\$ 448,182</b>

At September 30, 2008 and December 31, 2007, investment securities with a principal amount of \$434,773,000 and \$279,835,000, respectively, were pledged to secure repurchase agreements, public funds and trust fund deposits.

**NOTE I LOANS AND ALLOWANCE FOR LOAN LOSSES**

The composition of the loan portfolio was as follows:

<i>(dollars in thousands)</i>	<b>September 30, 2008</b>	<b>December 31, 2007</b>
Real estate construction	\$ 407,834	\$ 329,875
Real estate mortgages:		
Residential	844,378	610,250
Commercial	1,360,054	965,770
Commercial and industrial	879,664	815,306
Consumer	86,205	74,839
<b>Gross Portfolio Loans</b>	<b>3,578,135</b>	<b>2,796,040</b>
Allowance for loan losses	(43,235)	(34,345)
<b>Total Portfolio Loans</b>	<b>3,534,900</b>	<b>2,761,695</b>
Loans held for sale	452	899
<b>Total Loans</b>	<b>\$ 3,535,352</b>	<b>\$ 2,762,594</b>

Changes in the allowance for loan losses for the nine months ended September 30 were as follows:

<i>(dollars in thousands)</i>	<b>2008</b>	<b>2007</b>
Balance at beginning of year	\$ 34,345	\$ 33,220

Edgar Filing: S&T BANCORP INC - Form 10-Q

Charge-offs	(5,758)	(5,747)
Recoveries	1,911	2,046
<b>Net charge-offs</b>	<b>(3,847)</b>	<b>(3,701)</b>
Provision for loan losses	7,317	4,625
Acquired loan loss reserve	5,420	
<b>Balance at end of period</b>	<b>\$ 43,235</b>	<b>\$ 34,144</b>

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

The principal balances of loans on nonaccrual status were \$32,793,000 and \$16,798,000 at September 30, 2008 and December 31, 2007, respectively. Other real estate owned, which is included in other assets, was \$1,111,000 at September 30, 2008 and \$488,000 at December 31, 2007.

The following table represents S&T's investment in loans considered to be impaired and related information on those impaired loans as of September 30, 2008 and December 31, 2007:

<i>(dollars in thousands)</i>	<b>September 30, 2008</b>	<b>December 31, 2007</b>
Recorded investment in loans considered to be impaired	\$ 45,871	\$ 14,965
Recorded investment in impaired loans with no related allowance for loan losses	18,594	10,332
Loans considered to be impaired that were on a nonaccrual basis	16,006	6,356
Allowance for loan losses related to loans considered to be impaired	6,713	2,919
Average recorded investment in impaired loans	26,727	21,110
Total interest income per contractual terms on impaired loans	1,823	1,710
Interest income on impaired loans recognized on a cash basis	800	461

**NOTE J BORROWINGS**

Following is a summary of short-term borrowings at:

<i>(dollars in thousands)</i>	<b>September 30, 2008</b>	<b>December 31, 2007</b>
Securities sold under repurchase agreements	\$ 174,656	\$ 84,458
Federal funds purchased		15,800
Federal Home Loan Bank Advances	377,850	80,000
<b>Total</b>	<b>\$ 552,506</b>	<b>\$ 180,258</b>

Short-term borrowings are for terms under one year and were comprised of retail repurchase agreements ( REPOs ), wholesale REPOs, federal funds purchased and Federal Home Loan Bank ( FHLB ) advances. S&T defines repurchase agreements with its local retail customers as retail REPOs; short-term wholesale REPOs are those transacted with other banks and brokerage firms. Securities pledged as collateral under these REPOs financing arrangements cannot be sold or repledged by the secured party. The fair value of collateral provided to a third party is continually monitored, and additional collateral is obtained or requested to be returned as appropriate. Federal funds purchased are unsecured overnight borrowings with other financial institutions; overnight and FHLB advances are for various terms secured by a blanket lien on securities, residential mortgages and other loans with the FHLB of Pittsburgh.

Following is a summary of long-term debt at:

<i>(dollars in thousands)</i>	<b>September 30, 2008</b>	<b>December 31, 2007</b>
Long-term borrowings	\$ 190,302	\$ 201,021
Junior subordinated debt securities	90,619	25,000

<b>Total</b>	<b>\$ 280,921</b>	<b>\$ 226,021</b>
--------------	-------------------	-------------------

The purpose of these long-term borrowings is to match-fund selected new loan originations, to mitigate interest-rate sensitivity risk and to take advantage of discounted borrowing rates through the FHLB for community investment projects. S&T had long-term debt outstanding of \$187.2 million at September 30, 2008 at a fixed rate and \$93.7 million at a variable rate. Long-term borrowings included \$50.0 million of repurchase agreement borrowings with embedded floors. The weighted average rates were 4.23 percent and 5.52 percent at September 30, 2008 and December 31, 2007, respectively.



---

**Table of Contents**

**S&T BANCORP, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

During the first quarter of 2008, S&T completed a private placement to a financial institution of \$20.0 million of floating rate trust preferred securities. The trust preferred securities mature in March 2038, and are callable after five years, and bear interest initially at a rate of 6.44 percent per annum and adjusts quarterly with the three-month LIBOR plus 350 basis points.

During the second quarter of 2008, S&T Bank issued \$20.0 million of junior subordinated debt through a private placement with three financial institutions at an initial rate of 6.40 percent and floats quarterly with 3-month LIBOR plus 350 basis points. If all or any portion of the subordinated debt ceases to be deemed to be Tier 2 Capital due to a change in applicable capital regulations, S&T will have the right to redeem, on any interest payment date, subject to a 30 day written notice and prior approval by the FDIC, the subordinated debt at the applicable redemption rate which starts at a high of 102.82 percent at June 15, 2009 and decreases yearly to 100 percent on June 15, 2013 and thereafter and can be called after five years. The subordinated debt qualifies as Tier 2 capital under regulatory guidelines and will mature on June 15, 2018.

Also during the second quarter of 2008, S&T Bank issued \$25.0 million of junior subordinated debt through a private placement with a financial institution at an initial rate of 5.15 percent and floats quarterly with 3-month LIBOR plus 250 basis points. At any time after May 30, 2013, S&T will have the right to redeem all or a portion of the subordinated debt, subject to a 30 day written notice and prior approval by the FDIC. The subordinated debt qualifies as Tier 2 capital under regulatory guidelines and will mature on May 30, 2018. The subordinated debt qualifies as Tier 2 capital under regulatory guidelines and will mature on June 15, 2018.

**NOTE K GUARANTEES**

S&T, in the normal course of business, commits to extend credit and issue standby letters of credit. The obligations are not recorded in S&T's financial statements. Loan commitments and standby letters of credit are subject to S&T's normal credit underwriting policies and procedures and generally require collateral based upon management's evaluation of each customer's financial condition and ability to satisfy completely the terms of the agreement. S&T's exposure to credit loss in the event the customer does not satisfy the terms of the agreement equals the notional amount of the obligation less the value of any collateral. Unfunded commercial loan commitments totaled \$783,887,000, unfunded other loan commitments, comprised of credit card lines and home equity lines, totaled \$176,307,000 and obligations under standby letters of credit totaled \$171,248,000 at September 30, 2008.

**NOTE L LITIGATION**

S&T, in the normal course of business, is subject to various legal proceedings in which claims for monetary damages are asserted. Management does not believe that the outcome of any current proceedings will have a material adverse effect on the consolidated financial position of S&T.

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis is presented so that shareholders may review in further detail the financial condition and results of operations of S&T Bancorp, Inc. and subsidiaries (S&T). This discussion and analysis should be read in conjunction with the condensed consolidated financial statements and the other financial data presented elsewhere in this report.

**Business Summary**

S&T is a financial holding company with its headquarters located in Indiana, Pennsylvania and with assets of approximately \$4.5 billion at September 30, 2008. S&T provides a full range of financial services through a branch network of 55 offices located in Allegheny, Armstrong, Blair, Butler, Cambria, Clarion, Clearfield, Indiana, Jefferson and Westmoreland counties of Pennsylvania. S&T provides full service retail and commercial banking products as well as cash management services; insurance; financial and estate planning; estate and trust administration; investment management; employee benefit services and administration; corporate services and other fiduciary services. S&T's common stock trades on the Nasdaq Global Select Market under the symbol STBA.

## Edgar Filing: S&T BANCORP INC - Form 10-Q

On June 6, 2008, S&T completed its acquisition of IBT, pursuant to an Agreement and Plan of Merger, by and between S&T and IBT, dated December 16, 2007 (the Merger Agreement ). Pursuant to the terms of the Merger Agreement, which was approved by the shareholders of IBT on May 13, 2008, IBT was merged with and into S&T, with the S&T being the

**Table of Contents**

**S&T BANCORP, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF**

**OPERATIONS continued**

surviving corporation (the Merger). In connection with the Merger, IBT shareholders received for each share of IBT common stock they hold, at their election, either \$31.00 in cash or 0.93 of a share of S&T common stock. IBT shareholders could elect to receive all cash, all S&T common stock, or a combination of cash and S&T common stock for their shares of IBT common stock, subject to the allocation procedures described in the Merger Agreement. Holders of options to purchase IBT common stock had their stock options cancelled for a cash payment equal to the difference between \$31.00 and the exercise price per share for each such stock option, which IBT paid immediately prior to the merger.

S&T issued a total of 2,751,749 shares of S&T common stock at a recorded fair value of \$91.7 million and paid a total of \$75.1 million in cash to the former IBT shareholders.

**Recent Government Regulation**

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the Act) was signed into law. The Act allocates up to \$700 billion towards purchasing and insuring troubled assets held by financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets. The Act establishes the basic framework and policy goals, and vests with the United States Treasury Department (UST) the authority to carry out the Act's purpose.

On October 14, 2008, UST announced a voluntary Trouble Asset Relief Purchase Program (the Program) whereby UST will purchase senior preferred shares from qualifying United States financial institutions. Each participating institution may sell an amount of senior preferred shares ranging from 1.0% to 3.0% of its risk-weighted assets. The preferred shares are generally nonvoting, pay an initial dividend rate of 5.0% per year for the first five years increasing to 9.0% per year after year five, and are callable at par after three years or sooner with the proceeds of a qualifying offering of Tier 1 perpetual preferred stock or common stock for cash. UST will receive warrants to acquire common stock from the participating institution having an aggregate market price equal to 15.0% of the amount of capital invested by UST in the senior preferred shares and an exercise price equal to the average trailing 20-trading day market price of the institution's common stock at the time of issuance. Participating institutions must agree to certain limitations on executive compensation, repurchases of junior preferred or common stock and increases in common stock dividend payments. The deadline for submitting an application to participate in the Program is November 14, 2008. S&T is in the process of fully analyzing the benefits and costs of participating in the Program in order to make a final determination as to whether or to what extent we would participate in the Program.

**Financial Condition**

Total assets averaged \$3.8 billion in the first nine months of 2008 and \$3.3 billion for the 2007 full year average. Average loans increased \$391.4 million and average securities, other investments and federal funds sold increased \$14.4 million in the first nine months of 2008 as compared to the 2007 full year average. Average deposits increased \$199.9 million and average borrowings increased \$217.1 million during the nine months ended September 30, 2008 as compared to the 2007 full year average.

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF****OPERATIONS continued****Average Balance Sheet and Net Interest Income Analysis**

<i>(dollars in millions)</i>	Nine Months Ended September 30, 2008			Twelve Months Ended December 31, 2007		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>Assets</b>						
Loans (1)	\$ 3,123.2	\$ 148.0	6.33%	\$ 2,731.8	\$ 202.1	7.40%
Securities/other (1)	409.6	14.1	4.58%	395.2	18.3	4.63%
<b>Total interest-earning assets</b>	<b>3,532.8</b>	<b>162.1</b>	<b>6.13%</b>	<b>3,127.0</b>	<b>220.4</b>	<b>7.05%</b>
Noninterest-earning assets	287.6			209.1		
<b>TOTAL</b>	<b>\$ 3,820.4</b>			<b>\$ 3,336.1</b>		
<b>Liabilities And Shareholders' Equity</b>						
NOW/money market/savings	\$ 1,243.6	\$ 11.9	1.27%	\$ 1,217.4	\$ 37.5	3.08%
Time deposits	1,038.5	27.6	3.56%	934.7	42.1	4.50%
Borrowed funds < 1 year	329.1	5.2	2.11%	140.4	6.6	4.70%
Borrowed funds > 1 year	264.7	10.3	5.18%	236.3	13.0	5.51%
<b>Total interest-bearing liabilities</b>	<b>2,875.9</b>	<b>55.0</b>	<b>2.55%</b>	<b>2,528.8</b>	<b>99.2</b>	<b>3.92%</b>
Noninterest-bearing liabilities:						
Demand deposits	511.6			441.7		
Shareholders' equity/other	432.9			365.6		
<b>TOTAL</b>	<b>\$ 3,820.4</b>			<b>\$ 3,336.1</b>		
<b>Net yield on interest-earning assets</b>			<b>4.05%</b>			<b>3.87%</b>
<b>Net Interest Income</b>		<b>\$ 107.1</b>			<b>\$ 121.2</b>	

(1) The yield on earning assets and the net interest margin are presented on a fully tax-equivalent (FTE) and annualized basis. The FTE basis adjusts for the tax benefit of income on certain tax-exempt loans and investments using the federal statutory tax rate of 35 percent for each period presented. S&T believes this measure to be the preferred industry measurement of net interest income and provides relevant comparison between taxable and non-taxable amounts.

**Lending Activity**

Average loans increased \$391.4 million to \$3.1 billion during the nine months ended September 30, 2008 as compared to the 2007 full year average. Changes in the composition of the average loan portfolio included increases of \$101.9 million of commercial and industrial loans, \$129.1 million of residential mortgages and home equity loans, \$157.4 million of commercial real estate loans and \$3.0 million of consumer loans. S&T acquired \$207.9 million of average loans with the IBT acquisition. The composition of the average acquired loan portfolio included

## Edgar Filing: S&T BANCORP INC - Form 10-Q

\$19.5 million of commercial and industrial loans, \$88.9 million of residential mortgages and home equity loans, \$94.0 of commercial real estate loans and \$5.5 million of consumer loans.

Average commercial loans, including commercial real estate, commercial and industrial and real estate construction comprised 74 percent of the average loan portfolio for the nine months ended September 30, 2008 and 76 percent for the nine months ended September 30, 2007. Although commercial loans can have a relatively higher risk profile, management believes these risks are mitigated through active portfolio management, underwriting and continuous review. Rates and terms for commercial real estate, equipment loans and lines of credit are normally negotiated, subject to such variables as the financial condition of the borrower, economic conditions, marketability of collateral, credit history of the borrower and future cash flows. The loan to value policy guideline for commercial real estate loans is generally 65-85 percent. Variable-rate commercial loans were 57 percent of the commercial loan portfolio at September 30, 2008 and 48 percent at December 31, 2007.

Average residential mortgage loans comprised 23 percent of the average loan portfolio for the nine months ended September 30, 2008 and 22 percent for the nine months ended September 30, 2007. Residential mortgage lending continues to be a strategic focus in 2008 through our centralized mortgage origination department, ongoing product redesign, secondary market activities and the utilization of commission compensated originators. Management believes that S&T is fairly well insulated

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF****OPERATIONS continued**

from the impact of potential future declines in its local real estate market due to its conservative mortgage lending policies. The loan to value policy guideline is 80 percent for residential first lien mortgages. Higher loan to value loans may be approved with the appropriate private mortgage insurance coverage. Second lien positions are sometimes assumed with home equity loans, but normally only to the extent that the combined credit exposure for both the first and second liens does not exceed 100 percent of the fair value of the mortgage property. At September 30, 2008 and December 31, 2007, nine and ten percent, respectively, of the residential mortgage portfolio consisted of adjustable rate mortgages with repricing terms of one, three and five years.

S&T periodically designates specific loan originations, generally longer-term, lower-yielding 1-4 family mortgages as held for sale and sells them to Fannie Mae. The rationale for these sales is to mitigate interest rate risk associated with holding long-term residential mortgages in the loan portfolio, generate fee revenue from servicing, and maintain the primary customer relationship. During the nine months ended September 30, 2008 and 2007, S&T sold \$14.4 million and \$13.0 million, respectively, of 1-4 family mortgages and services \$174.5 million of secondary market mortgage loans to Fannie Mae at September 30, 2008. S&T intends to continue to sell longer-term loans to Fannie Mae in the future on a selective basis, especially during periods of lower interest rates.

Average consumer loans comprised three percent of the loan portfolio for the nine months ended September 30, 2008 and 2007. The average balance of consumer loans for the nine months ended September 30, 2008 was \$77.8 million as compared to \$74.8 million for the 2007 full year average. S&T offers a variety of unsecured and secured consumer loan and credit card products.

Management intends to continue to pursue quality loans in a variety of lending categories in order to enhance shareholder value. S&T's loan portfolio primarily represents loans to businesses and consumers in our market area of Western Pennsylvania. Management continues to develop and improve the effectiveness of our credit and loan administration processes and staff, which assists management in evaluating loans before they are made and in identifying problem loans early.

**Securities Activity**

Average securities, other investments and federal funds sold increased by \$14.5 million in the first nine months of 2008 compared to the 2007 full year average primarily due to \$110.5 million of average securities acquired with the IBT acquisition, offset by an average decrease of \$96.0 million in securities which is attributable to an S&T Asset Liability Committee (ALCO) strategy to limit the replacement of matured investment securities with borrowings to mitigate interest rate risk. The components of the increase of \$14.5 million include \$19.0 million in obligations of state and political subdivisions, \$18.6 million in mortgage-backed securities, \$7.6 million in other investments and \$0.8 million in other securities. Offsetting these increases are decreases of \$17.6 million in U.S. government corporations and agencies, \$13.0 million in marketable equity securities and \$0.3 million of U.S. treasury securities. During the second quarter of 2008, S&T restructured the IBT debt securities portfolio to conform to S&T's securities policy guidelines. The increase of \$7.6 million in other investments in the first nine months of 2008 compared to the 2007 full year average are comprised of Federal Home Loan Bank (FHLB) stock that is a membership and borrowing requirement and is recorded at historical cost. The amount of S&T's investment in FHLB stock depends upon S&T's borrowing availability and level from the FHLB. Average federal funds sold decreased \$0.6 million in the first nine months of 2008 compared to the 2007 full year average. At September 30, 2008, the equity securities portfolio had total market value of \$19.2 million compared to \$41.3 million at December 31, 2007 and net unrealized losses of \$0.3 million at September 30, 2008 compared to net unrealized gains of \$7.5 million at December 31, 2007. The primary cause of this market value decrease is due a general market decline, the retirement of \$14.6 million of IBT common stock held by S&T prior to the acquisition and a strategy over the past two years to methodically reduce the equities portfolio. The equity securities portfolio consists of securities traded on the various stock markets and is subject to changes in market value.

S&T's policy for security classification includes U.S. treasury securities, U.S. government corporations and agencies, mortgage-backed securities, collateralized mortgage obligations, states and political subdivisions, corporate securities, marketable equity securities and other securities classified as available for sale. On a quarterly basis, management evaluates the securities portfolios for other-than-temporary declines in market value in accordance with FASB issued Staff Position (FSP) FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. During the first nine months of 2008, there was \$3.9 million of realized losses taken for other-than-temporary impairment on five bank equity investment securities. The performance of the equities and debt securities markets could



---

**Table of Contents**

**S&T BANCORP, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF**

**OPERATIONS continued**

generate further impairment in future periods. At September 30, 2008, net unrealized losses on securities classified as available for sale, including equity securities, were \$1.1 million as compared to net unrealized gains of \$8.4 million at December 31, 2007. Net unrealized losses related to S&T's debt securities portfolio totaled \$0.8 million at September 30, 2008 and \$0.9 million unrealized gains at December 31, 2007. S&T has the intent and ability to hold debt and equity securities until maturity or until market value recovers above cost or until maturity.

**Allowance for Loan Losses**

The balance in the allowance for loan losses was \$43.2 million or 1.21 percent of total loans at September 30, 2008 as compared to \$34.3 million or 1.23 percent of total loans at December 31, 2007. The increase in the allowance for loan losses is consistent with the growth of internally generated loans and \$5.4 million of allowance for loan losses associated with the IBT acquisition. The allowance for loan losses also increased as a result of the establishment of \$5.4 million of specific reserves for three commercial real estate loan credits during the third quarter of 2008, offset by the resolution of two commercial loan credits during the second quarter of 2008. S&T's allowance for lending-related commitments such as unfunded commercial real estate, commercial and industrial term loan commitments and letters of credit totaled \$1.8 million at September 30, 2008 and \$0.9 million at December 31, 2007. The increase is primarily due to one troubled commercial letter of credit totaling \$1.2 million. The allowance for lending-related commitments is included in other liabilities.

Problem loans are identified and continually monitored through detailed reviews of specific commercial loans, and the analysis of delinquency and charge-off levels of consumer loan portfolios. Management evaluates the degree of loss exposure for loans on a continuous basis through a formal allowance for loan loss policy as administered by S&T Bank's Loan Administration Department and various management and director committees. Updates are presented to the S&T Board of Directors as to the status of loan quality. Charged-off and recovered loan amounts are applied to the allowance for loan losses. The allowance for loan losses is increased through a charge to current earnings through the provision for loan losses, based upon management's assessment of the adequacy of the allowance for loan losses. A quantitative analysis is utilized to support the adequacy of the allowance for loan losses. This analysis includes a review of the historical charge-off rates for all loan categories as well as fluctuations and trends in various risk factors that have occurred within the portfolios economic life cycle. The analysis includes assessment of qualitative factors such as credit trends, unemployment trends, vacancy trends, loan growth and the degree of variable interest rate risk. Should any of the factors considered by management in evaluating the adequacy of the allowance for loan losses change, S&T's estimate of loan losses could also change.

Significant to this analysis and assessment is the loan portfolio composition of a higher mix of commercial loans. These loans are generally larger in size and, due to the continuing growth, many are not seasoned and may be more vulnerable to an economic slowdown. Management relies on its risk rating process to assess potential weaknesses within specific credits. Current risk factors, trends in risk ratings and historical charge-off experiences are considered in the determination of the allowance for loan losses. During the first nine months of 2008, the risk rating profile of the portfolio was primarily impacted by six commercial loan relationships, and two of these commercial loan relationships were resolved during second quarter of 2008. The first commercial loan relationship was a construction company with residual loan exposure of \$3.7 million. The bank negotiated a settlement resulting in a recovery of \$0.8 million. In the third quarter of 2007, S&T previously recorded a charge of \$7.2 million for this loan relationship. Concurrent with the settlement, S&T released a specific reserve of \$2.0 million, which had been established in the second quarter of 2007. The second relationship is a sales and service company with loan exposure of \$3.6 million. S&T negotiated a settlement resulting in a \$1.1 million charge. This was partially offset with the release of a specific reserve of \$0.9 million, which had been established in the first quarter of 2008. The third commercial loan relationship was an internet marketing company totaling \$1.2 million that was placed on nonperforming status and specific a reserve of \$1.2 million was allocated to this commercial loan relationship during the second quarter of 2008.

During the third quarter of 2008, S&T established \$5.4 million of specific reserves on three commercial real estate loans totaling \$26.1 million. The first relationship is apartment rental complexes in western Pennsylvania with residual loan exposure of \$15.4 million, and a specific reserve of \$2.5 million has been allocated to this relationship. The second relationship is a condominium project with a residual loan exposure of \$8.8 million. A specific reserve of \$1.8 million has been established for this relationship. This relationship was placed into nonperforming status during the third quarter of 2008. The third relationship is within the food services industry with residual loan exposure of \$1.9 million, and a specific reserve of \$1.1 million has been allocated to this relationship. This relationship was placed into nonperforming status during the third quarter of 2008. Management believes these commercial relationships have been adequately reserved as determined by the quarterly impairment



analysis and risk-rating process performed by the Loan Administration Department.

---

**Table of Contents**

**S&T BANCORP, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF**

**OPERATIONS continued**

Net loan charge-offs totaled \$3.8 million or 0.16 percent of average loans on an annualized basis for the first nine months of 2008 as compared to \$3.7 million or 0.18 percent of average loans on an annualized basis in the first nine months of 2007.

Net loan charge-offs during the first nine months of 2008 were primarily impacted by a \$1.1 million charge-off on a loan with the aforementioned sales and service company in the second quarter of 2008, a \$0.9 million charge-off on a construction company loan during the third quarter of 2008, offset by a \$0.8 million recovery on the loan with aforementioned construction company. The balance of nonperforming loans, which included loans past due 90 days or more, at September 30, 2008 was \$32.8 million or 0.92 percent of total loans. This compares to nonperforming loans of \$16.8 million or 0.60 percent of total loans at December 31, 2007. Nonperforming assets totaled \$33.9 million or 0.76 percent of total assets at September 30, 2008 and \$17.3 million or 0.51 percent of total assets at December 31, 2007. There are no loans 90 days past due and still accruing interest. The provision for loan losses was \$7.3 million for the first nine months of 2008, as compared to \$4.6 million for the same period of 2007. The provision was the result of management's detailed analysis of the adequacy of the allowance for loan losses and is consistent with commercial loan growth, loan charge-off levels and the level of specific reserves established for impaired commercial loan relationships, offset by the resolution of the two aforementioned commercial loan relationships.

**Deposits**

Average total deposits increased by \$199.9 million, or 8 percent, during the nine months ended September 30, 2008 as compared to the 2007 full year average. Changes in the average deposit mix include increases of \$104.2 million in certificates of deposit, \$69.5 million in demand deposits, \$34.8 million in money market accounts and \$34.7 million in NOW accounts. Offsetting these increases is a decrease of \$43.3 million in savings accounts. S&T acquired \$242.6 million of average deposits with the IBT acquisition. The composition of these acquired deposits included \$119.0 million in certificates of deposit, \$58.8 million in demand and NOW accounts, \$34.3 million of money market accounts and \$30.5 million of savings accounts. The decrease in savings accounts is primarily attributable to S&T being less aggressive with competitive pricing strategies as borrowings currently have a slight pricing advantage. We are willing to accept slightly less robust deposit growth in the short-term in order to take advantage of these unique circumstances.

S&T Cash Management accounts totaled \$628.8 million at September 30, 2008 and \$811.6 million at December 31, 2007 and has an account pricing feature that allows S&T to better complement shifting interest rate sensitivity. Other important strategies include providing cash management services to commercial customers to increase transaction related deposits, and enhanced delivery services such as electronic banking. Core deposit growth is an important strategic initiative for S&T, through the expansion of retail facilities, promotions and new products.

Management believes that the S&T deposit base is stable and that S&T has the ability to attract new deposits, mitigating a funding dependency on other more volatile sources. Certificates of deposit of \$100,000 and over were eleven and ten percent of total deposits at September 30, 2008 and at December 31, 2007, respectively, and primarily represent deposit relationships with local customers in our market area. In addition, when market conditions permit, management believes that S&T has the ability to access both public and private markets to raise long-term funding if necessary. S&T had \$52.1 and \$2.8 million of brokered retail certificates of deposit outstanding at September 30, 2008 and December 31, 2007, respectively. The issuance of brokered retail certificates of deposits is an ALCO strategy to increase liquidity for loan demand, as an alternative to increased borrowings.

**Borrowings**

Average borrowings by S&T increased \$217.0 million for the first nine months of 2008 as compared to full year 2007 average. The increase is the result of increased loan growth that was not fully funded by maturing investment securities or deposit growth, and to take advantage of low short-term funding sources. Borrowings are comprised of retail repurchase agreements ( REPOs ), wholesale REPOs, federal funds purchased, FHLB advances and long-term borrowings. S&T defines REPOs with our local retail customers as retail REPOs; wholesale REPOs are those transacted with other banks and brokerage firms with terms normally ranging from one to 365 days.



**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF****OPERATIONS continued**

The largest increase in average borrowings for the first nine months of 2008 is a \$158.5 million increase in FHLB advances compared to the 2007 full year average. FHLB advances are being utilized to fund loan growth as this type of borrowing has a slight pricing advantage for S&T. The average balance in retail REPOs increased approximately \$48.0 million for the first nine months of 2008 compared to the 2007 full year average. S&T views retail REPOs as a relatively stable source of funds because most of these accounts are with local long-term customers. There has been a growing customer preference for retail REPOs due to the secured features of these accounts during these times of economic concern. Average federal funds purchased decreased by \$8.0 million and average wholesale REPOs decreased by \$9.8 million for the first nine months of 2008 compared to the full year 2007 average.

Average long-term borrowings have increased by \$28.3 million in the first nine months of 2008 as compared to the full year 2007 average. S&T had long-term borrowings outstanding of \$187.2 million at September 30, 2008 at a fixed rate and \$93.7 million at a variable rate.

During the first quarter of 2008, S&T completed a private placement to a financial institution of \$20.0 million of floating rate trust preferred securities. The trust preferred securities mature in March 2038, and are callable at S&T's option, after five years, and bear interest initially at a rate of 6.44 percent per annum and quarterly adjusts with the three-month LIBOR plus 350 basis points. S&T will make interest payments to the trustee beginning on June 15, 2008 and quarterly thereafter. The proceeds from the sale of the trust preferred securities was used to partially finance the acquisition of IBT.

During the second quarter of 2008, S&T Bank issued \$20.0 million of junior subordinated debt through a private placement with three financial institutions at an initial rate of 6.40 percent and floats quarterly with 3-month LIBOR plus 350 basis points. If all or any portion of the subordinated debt ceases to be deemed to be Tier 2 Capital due to a change in applicable capital regulations, S&T will have the right to redeem, on any interest payment date, subject to a 30 day written notice and prior approval by the FDIC, the subordinated debt at the applicable redemption rate which starts at a high of 102.82 percent at June 15, 2009 and decreases yearly to 100 percent on June 15, 2013 and thereafter and can be called after five years. The subordinated debt qualifies as Tier 2 capital under regulatory guidelines and will mature on June 15, 2018.

Also during the second quarter of 2008, S&T Bank issued \$25.0 million of junior subordinated debt through a private placement with a financial institution at an initial rate of 5.15 percent and floats quarterly with 3-month LIBOR plus 250 basis points. At any time after May 30, 2013, S&T will have the right to redeem all or a portion of the subordinated debt, subject to a 30-day written notice and prior approval by the FDIC. The subordinated debt qualifies as Tier 2 capital under regulatory guidelines and will mature on May 30, 2018. The proceeds from the sale of these two subordinated debt issuances were also used to partially finance the acquisition of IBT.

**Capital Resources**

Shareholders' equity increased \$113.2 million at September 30, 2008, compared to December 31, 2007. Net income was \$44.4 million, and dividends paid to shareholders were \$23.7 million for the nine months ended September 30, 2008. Also effecting capital is a decrease of \$84.0 million in treasury stock primarily as a result of issuing 2,751,749 shares to the former IBT shareholders as well as an increase of \$6.2 million in unrealized losses on securities available for sale, net of tax, which is included in other comprehensive income. The S&T Board of Directors authorized stock buyback programs in 2005 and 2006 of one million shares each, or approximately four percent of shares outstanding in each year. On June 18, 2007, S&T's Board of Directors authorized an additional buyback program of one million shares until June 30, 2008. During 2007, S&T repurchased 971,400 shares through these programs at an average cost of \$32.74 per share. During the first nine months of 2008, there were no purchases of S&T common stock under the 2007 program. During 2008, S&T's Board of Directors did not authorize any additional buyback programs.

S&T paid 53 percent of net income in dividends, equating to a projected annual dividend yield of approximately three percent utilizing the September 30, 2008 closing market price of \$36.83. The book value of S&T's common stock was \$16.34 at September 30, 2008 and \$13.75 at December 31, 2007. S&T continues to maintain a strong capital position with a leverage ratio of 7.2 percent at September 30, 2008 and 8.6 percent at December 31, 2007 as compared to the minimum regulatory guideline of 3.0 percent. S&T's risk-based capital Tier I and Total ratios were 8.2 percent and 11.4 percent, respectively, at September 30, 2008 and 9.5 percent and 11.6 percent respectively at December 31, 2007. These ratios place S&T above the Federal Reserve Board's risk-based capital guidelines of 4.0 percent and 8.0 percent for Tier I and Total,

respectively.

During 2003, S&T filed a shelf registration statement on Form S-3 under the Securities Act of 1933, as amended, with the SEC for the issuance of up to \$150.0 million of a variety of securities including debt and capital securities, preferred and

---

**Table of Contents**

**S&T BANCORP, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF**

**OPERATIONS continued**

common stock and warrants. S&T can use the proceeds from the sale of any securities for general corporate purposes, which could include investments at the holding company level, investing in, or extending credit to, its subsidiaries, possible acquisitions and stock repurchases. As of September 30, 2008, S&T had not utilized the shelf registration statement.

In addition to the results of operations presented in accordance with GAAP, S&T management uses, and this quarterly report contains or references, certain non-GAAP financial measures, such as net interest income on a fully tax-equivalent basis and operating revenue. S&T believes these non-GAAP financial measures provide information useful to investors in understanding our underlying operational performance and our business and performance trends as they facilitate comparisons with the performance of others in the financial services industry. Although S&T believes that these non-GAAP financial measures enhance investors' understanding of S&T's business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP measures.

We believe the presentation of net interest income on a fully tax-equivalent basis ensures comparability of net interest income arising from both taxable and tax-exempt sources and is consistent with industry practice. Interest income per the consolidated statements of income is reconciled to net interest income adjusted to a fully tax-equivalent basis on pages 26 and 30.

Operating revenue is the sum of net interest income and noninterest income less security gains. In order to understand the significance of net interest income to S&T's business and operating results, S&T management believes it is appropriate to evaluate the significance of net interest income as a component of operating revenue.

**RESULTS OF OPERATIONS**

**Nine months ended September 30, 2008 compared to**

**Nine months ended September 30, 2007**

**Net Income**

Net income was \$44.4 million or \$1.71 diluted earnings per share for the first nine months of 2008 as compared to \$42.8 million or \$1.72 diluted earnings per share for the same period of 2007. The increase in net income during the first nine months of 2008 was primarily the result of increases in net interest income and an increase in noninterest income, offset by lower security gains, higher provision for loan losses and an increase in noninterest expense compared to the first nine months of 2007. The difference between changes in net income and earnings per share is primarily due to the 2.8 million shares issued as partial payment for the IBT acquisition in the second quarter of 2008. The return on average assets was 1.55 percent for the nine months ended September 30, 2008, as compared to 1.71 percent for the nine months ended September 30, 2007. The return on average equity was 15.19 percent for the nine months ended September 30, 2008 compared to 17.37 percent for the same period of 2007.

**Net Interest Income**

Net interest income on a fully taxable equivalent basis was \$107.1 million, a \$17.1 million or 19 percent increase for the first nine months of 2008 as compared to \$90.0 million for the same period of 2007. The increase in net interest income was a result of a \$409.6 million increase in average interest-earning assets and improvement in the net interest margin. \$318.3 million of this growth is related to the IBT acquisition. The net interest margin on a fully taxable equivalent basis was 4.05 percent in the first nine months of 2008 as compared to 3.85 percent in the same period of 2007. The increase in the net interest margin is primarily attributable to the effect of decreasing short-term interest rates, in combination with an increasingly sloped yield curve, strong loan growth and better loan pricings. S&T's balance sheet is currently liability sensitive, with funding costs decreasing faster than asset yields during the first nine months of 2008.

## Edgar Filing: S&T BANCORP INC - Form 10-Q

For the first nine months of 2008, average loans increased \$403.5 million, and average securities and federal funds sold increased \$6.0 million as compared to the same period of 2007. S&T acquired \$207.9 million of average loans and \$110.5 million of average securities with the IBT acquisition. The \$195.6 million of average organic loan growth is attributable to commercial loans. The yields on average loans decreased by 112 basis points from the comparable period in 2007 and the yield on average securities decreased by three basis points. Overall yields on interest-earning assets were 6.13 percent and 7.09 percent for the nine months ended September 30, 2008 and 2007, respectively.

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF****OPERATIONS continued**

For the first nine months of 2008, balances of average interest-bearing deposits increased by \$139.1 million as compared to the same period of 2007. S&T acquired \$201.8 million of average interest-bearing deposits with the IBT acquisition. The average organic decrease of \$62.7 million is attributable to S&T being less aggressive with competitive pricing strategies, as borrowings currently have a slight pricing advantage. The cost of deposits totaled 2.31 percent, a decrease of 145 basis points from the comparable period in 2007 due to lower rates paid on both core and time deposits. The cost of REPOs and other borrowed funds decreased 180 basis points to 3.48 percent as a result of lower short-term rates as compared to the same period of 2007. Overall funding costs decreased 145 basis points to 2.55 percent at September 30, 2008 as compared to the same period of 2007. Positively affecting net interest income was a \$60.7 million increase in average net free funds during the first nine months of 2008 as compared to the same period of 2007. Average net free funds are the excess of demand deposits, other non-interest bearing liabilities and shareholders' equity over nonearning assets. The increase is primarily due to successful marketing of new demand accounts and corporate cash management services, acquired balances in the IBT acquisition and increased retained earnings.

Net interest income represents the difference between the interest and fees earned on interest-earning assets and the interest paid on interest-bearing liabilities. Net interest income is affected by changes in the volume of interest-earning assets and interest-bearing liabilities and changes in interest yields and rates. Maintaining consistent spreads between interest-earning assets and interest-bearing liabilities is very significant to our financial performance because net interest income comprised 78 percent and 75 percent of operating revenue (net interest income plus noninterest income, excluding security gains) in the first nine months of 2008 and 2007. The level and mix of interest-earning assets and funds are continually monitored by ALCO in order to mitigate the interest-rate sensitivity and liquidity risks of the balance sheet. A variety of ALCO strategies were successfully implemented, within prescribed ALCO risk parameters, to maintain an acceptable net interest margin given the challenges of the current interest rate environment and the shifting yield curve.

The following table reconciles interest income per the consolidated statements of income to net interest income adjusted to a fully tax-equivalent basis:

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>
<i>(dollars in thousands)</i>		
Interest income per consolidated statements of income	\$ 158,307	\$ 161,969
Adjustment to fully taxable equivalent basis	3,760	3,572
<b>Interest income adjusted to fully taxable equivalent basis</b>	<b>162,067</b>	<b>165,541</b>
Interest expense	54,945	75,532
<b>Net interest income adjusted to fully taxable equivalent basis</b>	<b>\$ 107,122</b>	<b>\$ 90,009</b>



**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF****OPERATIONS continued****Average Balance Sheet and Net Interest Income Analysis**

<i>(dollars in millions)</i>	Nine Months Ended September 30, 2008			Nine Months Ended September 30, 2007		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>Assets</b>						
Loans (1)	\$ 3,123.2	\$ 148.0	6.33%	\$ 2,719.7	\$ 151.6	7.45%
Securities/other (1)	409.6	14.1	4.58%	403.6	13.9	4.61%
<b>Total interest-earning assets</b>	<b>3,532.8</b>	<b>162.1</b>	<b>6.13%</b>	<b>3,123.3</b>	<b>165.5</b>	<b>7.09%</b>
Noninterest-earning assets	287.6			209.2		
<b>TOTAL</b>	<b>\$ 3,820.4</b>			<b>\$ 3,332.5</b>		
<b>Liabilities And Shareholders' Equity</b>						
NOW/money market/savings	\$ 1,243.6	\$ 11.9	1.27%	\$ 1,205.9	\$ 28.7	3.18%
Time deposits	1,038.5	27.6	3.56%	937.1	31.7	4.52%
Borrowed funds < 1 year	329.1	5.2	2.11%	146.1	5.3	4.90%
Borrowed funds > 1 year	264.7	10.3	5.18%	238.0	9.8	5.52%
<b>Total interest-bearing liabilities</b>	<b>2,875.9</b>	<b>55.0</b>	<b>2.55%</b>	<b>2,527.1</b>	<b>75.5</b>	<b>4.00%</b>
Noninterest-bearing liabilities:						
Demand deposits	511.6			441.8		
Shareholders' equity/other	432.9			363.6		
<b>TOTAL</b>	<b>\$ 3,820.4</b>			<b>\$ 3,332.5</b>		
<b>Net yield on interest-earning assets</b>			<b>4.05%</b>			<b>3.85%</b>
<b>Net Interest Income</b>		<b>\$ 107.1</b>			<b>\$ 90.0</b>	

(1) The yield on earning assets and the net interest margin are presented on a fully taxable-equivalent (FTE) and annualized basis. The FTE basis adjusts for the tax benefit of income on certain tax-exempt loans and investments using the federal statutory tax rate of 35 percent for each period presented. S&T believes this measure to be the preferred industry measurement of net interest income and provides relevant comparison between taxable and non-taxable amounts.

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF****OPERATIONS continued**

The following table sets forth for the periods indicated a summary of the changes in interest earned and interest paid resulting from changes in volume and changes in rates:

<i>(dollars in thousands)</i>	Nine Months Ended September 30, 2008 Compared to September 30, 2007 Increase (Decrease)(1)		
	Volume	Rate	Net
Interest earned on:			
Loans(2)	\$ 22,494	\$ (26,110)	\$ (3,616)
Securities/other(2)	210	(68)	142
<b>Total interest-earning assets</b>	<b>22,704</b>	<b>(26,178)</b>	<b>(3,474)</b>
Interest paid on:			
NOW/money market/savings	899	(17,756)	(16,857)
Time deposits	3,425	(7,440)	(4,015)
Borrowed funds < 1 year	6,699	(6,863)	(164)
Borrowed funds > 1 year	1,101	(652)	449
<b>Total interest-bearing liabilities</b>	<b>12,124</b>	<b>(32,711)</b>	<b>(20,587)</b>
<b>Change in net interest income</b>	<b>\$ 10,580</b>	<b>\$ 6,533</b>	<b>\$ 17,113</b>

- (1) The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.
- (2) Tax-exempt income is on a fully tax-equivalent basis using the statutory federal corporate income tax rate of 35 percent for 2008 and 2007.

**Provision for Loan Losses**

The provision for loan losses was \$7.3 million for the first nine months of 2008 and \$4.6 million for the same period of 2007. The provision is the result of management's assessment of credit quality statistics and other factors that would have an impact on probable losses in the loan portfolio, and the model used for determination of the adequacy of the allowance for loan losses. Changes within the allowance for loan loss model are directionally consistent with the growth in commercial loans, loan charge-off levels and impact of the six aforementioned commercial loan relationships during the first nine months of 2008.

Credit quality is the most important factor in determining the amount of the allowance for loan losses and the resulting provision. During the third quarter, S&T had an increase in delinquencies and nonperforming loan levels, primarily due to the two aforementioned commercial real estate credits. Also affecting the amount of the allowance for loan losses, and resulting provision, is loan growth and portfolio composition. Most of the loan growth during the first nine months of 2008 and 2007 is attributable to larger-sized commercial loans as well as the acquisition of IBT in second quarter 2008. For the first nine months of 2008, net loan charge-offs were \$3.8 million and net loan charge-offs were \$3.7 million for the first nine months 2007. The most significant net charge-offs in 2008 were the aforementioned \$1.1 million charge-off on a loan with a sales and service company that had a specifically assigned reserve of \$0.9 million and a \$0.9 million charge-off on a loan with a construction company.

**Noninterest Income**

Noninterest income, excluding security gains (losses), increased \$1.2 million or 4 percent, to \$29.3 million in the first nine months of 2008 as compared to the same 2007 period. Increases included \$1.3 million or 17 percent service charges on deposit accounts, \$0.6 million or ten percent in insurance commissions and an increase of \$0.3 million or five percent in wealth management fees, offset by decreases of \$0.6 million or eight percent in other noninterest income, \$0.3 million or 16 percent in letter of credit fees and a \$0.1 million or 7 percent in mortgage banking fees. The increase of \$1.3 million in service charges on deposit fees is primarily related to fees charged for insufficient funds and account analysis fees incurred during the period. The increase of \$0.6 million in insurance commissions is primarily attributable to stronger overall sales volumes during the period. The increase of \$0.3 million in wealth management fees is related to increased brokerage and annuity commissions. Offsetting these increases are decreases of \$0.6 million in other noninterest income primarily due to a reclassification of investment securities held in the deferred compensation plan trust to a trading classification from available for sale classification. The reclassification generated a one-time favorable adjustment of \$1.2 million in the third quarter of

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF****OPERATIONS continued**

2007 and \$1.2 million of current year market adjustment for the deferred compensation plans, offset by a \$0.4 million non-recurring gain from the Visa, Inc. initial public offering in the first quarter of 2008, a \$0.5 million increase in commercial swap fees, a \$0.8 million increase in debit/credit card activities and a \$0.1 million of debt prepayment gains associated with the IBT acquisition. The decrease of \$0.3 million in letter of credit fees is attributable to changing customer preferences for this type of product.

S&T recognized \$1.6 million of losses on available for sale securities in the first nine months of 2008 as compared to \$3.3 million of gains in the same period of 2007. Included in the 2008 results were \$0.7 million of realized losses from restructuring the IBT debt securities portfolio in the second quarter of 2008, and \$3.9 million of other-than-temporary impairment charges on five bank equity holdings in accordance with FSP 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. Partially offsetting the realized losses and impairments were \$3.0 million of realized equity security gains for the nine months ended September 30, 2008.

**Noninterest Expense**

Noninterest expense increased by \$8.9 million or 17 percent during the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. Salaries and employee benefit expense increased \$2.4 million or eight percent primarily attributable to the addition of 73 full-time equivalent staff, mostly due to the IBT acquisition, normal year-end merit increases and higher incentive accruals. Salaries and employee benefits were also affected by the current year market adjustment for the deferred compensation plans. Occupancy, furniture and equipment expense increased \$0.9 million or 13 percent during the first nine months of 2008 as compared to the same period 2007, as a result of the net acquisition of eight new branches with the IBT acquisition, and one *de novo* branch opened by S&T during the year. Data processing expense increased \$0.4 million or 11 percent as compared to the same period in 2007 as a result of conversion expenses related to the IBT acquisition, partially offset by the renegotiation of the current contract and a change in data communication processes. Marketing expenses increased \$0.7 million or 36 percent as a result of additional promotions and new customer account packages associated with the IBT acquisition. Amortization of intangibles increased \$0.4 million or 181 percent due to the IBT acquisition. Other noninterest expense increased \$4.1 million or 38 percent during the first nine months of 2008 and is primarily attributable to a \$1.6 million increase in the reserve for unfunded loan commitments, a \$1.4 million valuation adjustment for five affordable housing limited partnerships, a \$0.5 increase in amortization for affordable housing limited partnerships, a \$0.3 million increase in postage and supplies primarily associated with the IBT acquisition and a \$0.5 million increase in telephone expense due to a change in data communication processes.

S&T's efficiency ratio, which measures noninterest expense as a percent of noninterest income plus net interest income on a fully taxable equivalent basis, excluding security gains, was 46 percent for the nine months ended September 30, 2008 and for the same period of 2007.

**Federal Income Taxes**

Federal income tax expense increased \$0.2 million or one percent in the first nine months of 2008 as compared to the first nine months of 2007. The effective tax rate for the first nine months of 2008 was 27 percent and 28 percent in the same period of 2007, which is below the 35 percent statutory rate due to benefits resulting from tax-exempt interest, excludable dividend income and the tax benefits associated with Low Income Housing Tax Credit ( LIHTC ) and Federal Historic Tax Credit projects. S&T currently does not incur any alternative minimum tax.

**RESULTS OF OPERATIONS**

**Three months ended September 30, 2008 compared to**

**Three months ended September 30, 2007**

**Net Income**

## Edgar Filing: S&T BANCORP INC - Form 10-Q

Net income was \$15.7 million or \$0.57 diluted earnings per share for the third quarter of 2008 as compared to \$15.7 million or \$0.63 diluted earnings per share for the same period of 2007. The flat performance in terms of net income during the third quarter of 2008 was primarily the result of increased operating expenses, security losses, and a higher loan loss provision, offset by an increase in net interest income. The decrease in diluted earnings per share is primarily due to the

**Table of Contents**

**S&T BANCORP, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF**

**OPERATIONS continued**

2.8 million shares issued as partial payment for the IBT acquisition in the second quarter of 2008. The return on average assets was 1.44 percent at September 30, 2008, as compared to 1.86 percent at September 30, 2007. The return on average equity was 13.93 percent at September 30, 2008 compared to 19.17 percent for the same period of 2007.

**Net Interest Income**

On a fully tax-equivalent basis net interest income was \$40.6 million, a \$10.1 million or 33 percent increase for the three months ended September 30, 2008 as compared to \$30.4 million for the same period of 2007. The increase in net interest income was a result of \$834.2 million increase in average interest-earning assets and improvement in the net interest margin. \$752.0 million of this growth is related to the IBT acquisition. The net interest margin on a fully taxable equivalent basis improved to 4.07 percent for the three months ended September 30, 2008 as compared to the 3.86 percent in the same period of 2007. The increase in the net interest margin is primarily attributable to the effect of decreasing short-term interest rates, in combination with an increasingly sloped yield curve and strong loan growth with improved pricing.

For the three months ended September 30, 2008, average loans increased \$748.3 million, and average securities and federal funds sold increased \$85.9 million as compared to the same period of 2007. S&T acquired \$491.0 million of average loans and \$261.0 million of average securities with the IBT acquisition. The \$257.3 million of average organic loan growth is primarily attributable to commercial loans. The yields on average loans decreased by 136 basis points from the comparable period in 2007 and the yield on average securities decreased by seven basis points. Overall yields on earning assets were 5.91 percent for the three months ending September 30, 2008 and 7.10 percent for the three months ending September 30, 2007.

For the three months ended September 30, 2008, balances of average interest-bearing deposits increased by \$311.9 million as compared to the same period of 2007. S&T acquired \$476.6 million of average interest-bearing deposits with the IBT acquisition. The average organic decrease of \$164.7 is attributable to S&T being less aggressive with competitive pricing strategies, as borrowings currently have a slight pricing advantage. The cost of interest-bearing deposits totaled 1.96 percent, a decrease of 183 basis points from the comparable period in 2007 due to decreased rates paid on both core and time deposits. The cost of REPOs and other borrowed funds decreased 212 basis points to 3.08 percent as a result of lower short-term rates. Overall funding costs decreased 176 basis points to 2.23 percent for the three months ended September 30, 2008 as compared to the same period of 2007.

Positively affecting net interest income was a \$109.6 million increase in average net free funds during the third quarter of 2008 compared to the same period of 2007. Average net free funds are the excess of demand deposits, other non-interest bearing liabilities and shareholders' equity over nonearning assets. The increase is primarily due to successful marketing of new demand accounts and corporate cash management services, demand deposit balances acquired with the IBT acquisition and increased retained earnings.

Net interest income represents the difference between the interest and fees earned on interest-earning assets and the interest paid on interest-bearing liabilities. Net interest income is affected by changes in the volume of interest-earning assets and interest-bearing liabilities and changes in interest yields and rates. Therefore, maintaining consistent spreads between earning assets and interest-bearing liabilities is very significant to our financial performance because net interest income comprised 79 percent of operating revenue (net interest income plus noninterest income, excluding security gains) in the third quarter of 2008 and 74 percent in the same period of 2007. The level and mix of earning assets and funds are continually monitored by ALCO in order to mitigate the interest-rate sensitivity and liquidity risks of the balance sheet. A variety of ALCO strategies were successfully implemented within prescribed ALCO risk parameters, to maintain an acceptable net interest margin given the challenges of the current interest rate environment.

The following table reconciles interest income per the consolidated statements of income to net interest income adjusted to a fully tax-equivalent basis:

Edgar Filing: S&T BANCORP INC - Form 10-Q

<i>(dollars in thousands)</i>	Three Months Ended September 30,	
	2008	2007
Interest income per consolidated statements of income	\$ 57,416	\$ 54,761
Adjustment to fully taxable equivalent basis	1,385	1,170
<b>Interest income adjusted to fully taxable equivalent basis</b>	<b>58,801</b>	<b>55,931</b>
Interest expense	18,245	25,485
<b>Net interest income adjusted to fully taxable equivalent basis</b>	<b>\$ 40,556</b>	<b>\$ 30,446</b>

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF****OPERATIONS continued****Average Balance Sheet and Net Interest Income Analysis**

<i>(dollars in millions)</i>	Three Months Ended September 30, 2008			Three Months Ended September 30, 2007		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>Assets</b>						
Loans (1)	\$ 3,488.8	\$ 53.4	6.08%	\$ 2,740.5	\$ 51.4	7.44%
Securities/other (1)	472.5	5.4	4.58%	386.6	4.5	4.65%
<b>Total interest-earning assets</b>	<b>3,961.3</b>	<b>58.8</b>	<b>5.91%</b>	<b>3,127.1</b>	<b>55.9</b>	<b>7.10%</b>
Noninterest-earning assets	385.2			212.9		
<b>TOTAL</b>	<b>\$ 4,346.5</b>			<b>\$ 3,340.0</b>		
<b>Liabilities And Shareholders' Equity</b>						
NOW/money market/savings	\$ 1,303.2	\$ 3.0	0.92%	\$ 1,228.1	\$ 9.8	3.18%
Time deposits	1,185.5	9.3	3.11%	948.7	11.0	4.58%
Borrowed funds < 1 year	489.2	2.3	1.91%	113.4	1.3	4.56%
Borrowed funds > 1 year	281.0	3.6	5.12%	244.1	3.4	5.49%
<b>Total interest-bearing liabilities</b>	<b>3,258.9</b>	<b>18.2</b>	<b>2.23%</b>	<b>2,534.3</b>	<b>25.5</b>	<b>3.99%</b>
Noninterest-bearing liabilities:						
Demand deposits	597.8			447.0		
Shareholders' equity/other	489.8			358.7		
<b>TOTAL</b>	<b>\$ 4,346.5</b>			<b>\$ 3,340.0</b>		
<b>Net yield on interest-earning assets</b>			4.07%			3.86%
<b>Net Interest Income</b>		<b>\$ 40.6</b>			<b>\$ 30.4</b>	

(1) The yield on earning assets and the net interest margin are presented on a fully tax-equivalent ( FTE ) and annualized basis. The FTE basis adjusts for the tax benefit of income on certain tax-exempt loans and investments using the federal statutory tax rate of 35 percent for each period presented. S&T believes this measure to be the preferred industry measurement of net interest income and provides relevant comparison between taxable and non-taxable amounts.

The following table sets forth for the periods indicated a summary of the changes in interest earned and interest paid resulting from changes in volume and changes in rates:

Three Months Ended September 30, 2008 Compared to  
September 30, 2007 Increase (Decrease)(1)



Edgar Filing: S&T BANCORP INC - Form 10-Q

(dollars in thousands)	Volume	Rate	Net
<b>Interest earned on:</b>			
Loans(2)	\$ 14,037	\$ (12,080)	\$ 1,957
Securities/other(2)	1,006	(93)	913
<b>Total interest-earning assets</b>	<b>15,043</b>	<b>(12,173)</b>	<b>2,870</b>
<b>Interest paid on:</b>			
NOW/money market/savings	602	(7,421)	(6,819)
Time deposits	2,735	(4,436)	(1,701)
Borrowed funds < 1 year	4,319	(3,273)	1,046
Borrowed funds > 1 year	512	(278)	234
<b>Total interest-bearing liabilities</b>	<b>8,168</b>	<b>(15,408)</b>	<b>(7,240)</b>
<b>Change in net interest income</b>	<b>\$ 6,875</b>	<b>\$ 3,235</b>	<b>\$ 10,110</b>

- (1) The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.
- (2) Tax-exempt income is on a fully tax-equivalent basis using the statutory federal corporate income tax rate of 35 percent for 2008 and 2007.

---

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF****OPERATIONS continued****Provision for Loan Losses**

The provision for loan losses was \$6.2 million for the three months ended September 30, 2008 and \$1.1 million for the same period of 2007. The provision is the result of management's assessment of credit quality statistics and other factors that would have an impact on probable losses in the loan portfolio, and the model used for determination of the adequacy of the allowance for loan losses. Changes within the allowance for loan loss model are directionally consistent with the growth in commercial loans, loan charge-off levels and the impact of the three aforementioned commercial real estate loan relationships during the third quarter of 2008. During the third quarter, S&T had an increase in delinquencies and nonperforming loan levels.

Credit quality is the most important factor in determining the amount of the allowance for loan losses and the resulting provision. Also affecting the amount of the allowance for loan losses, and the resulting provision, is loan growth and portfolio composition. Most of the loan growth during the third quarter of 2008 and 2007 is attributable to larger-sized commercial loans. Net charged-off loans were \$1.7 million and \$2.8 million for the third quarter 2008 and 2007, respectively. The most significant charge-off in the third quarter of 2008 was the aforementioned \$0.9 million charge-off with a construction company.

**Noninterest Income**

Noninterest income, excluding security gains (losses), increased \$0.1 million or one percent for the three months ended September 30, 2008 as compared to 2007. Service charges and fees increased \$1.0 million or 38 percent primarily attributable to higher account analysis fees and insufficient funds fees due to customer behavior patterns during the third quarter of 2008, as well as a full quarter effect of IBT. The increase of \$0.4 million or 21 percent in wealth management fees is related to increased core wealth management fees, brokerage and annuity commissions. Insurance commissions increased \$0.2 million or 11 percent attributable to stronger overall sales volume during the third quarter of 2008. Other income decreased \$1.5 million or 42 percent in the third quarter of 2008 as compared to the same period of 2007 primarily due to the aforementioned one-time favorable adjustment for the deferred compensation plan trust of \$1.2 million in the third quarter of 2007 and \$0.6 million of current year market adjustment for the deferred compensation plan, offset by increases of \$0.3 million in debit/credit card revenues.

S&T recognized \$0.3 million of net losses on available for sale securities in the three months ended September 30, 2008 as compared to \$1.1 million of net gains in the same period of 2007. The decrease of \$1.5 million in realized security gains (losses) is the result of \$2.6 million of other-than-temporary impairment charges for two bank equity securities, offset by \$2.3 million of realized equity security gains for the three months ended September 30, 2008.

**Noninterest Expense**

Noninterest expense increased by \$4.2 million or 23 percent during the three months ended September 30, 2008 compared to the three months ended September 30, 2007. Salaries and employee benefit expense increased \$1.8 million or 18 percent primarily attributable to the effects of increased full-time equivalent staff levels as a result of the IBT acquisition, year-end merit increases and higher incentive accruals. Occupancy, furniture and equipment expense increased by \$0.4 million or 14 percent during the three months ended September 30, 2008 as compared to the same period 2007 as a result of the net acquisition of eight new branches with the IBT acquisition, and one de novo branch opened by S&T during the period. Data processing expense increased \$0.2 million or 16 percent in the third quarter of 2008 as compared to the third quarter of 2007 as a result of higher activity levels, offset by the renegotiation of the current contract and a change in data communication processes. Marketing expenses increased \$0.3 million or 46 percent as a result of additional promotions associated with the IBT acquisition. Amortization of intangibles increased \$0.3 million or 404 percent due to the IBT acquisition. Other noninterest expense increased \$1.2 million or 35 percent during the third quarter of 2008 as compared to the same period in 2007, and is primarily attributable to a \$0.6 million increase in amortization for affordable housing limited partnerships, a \$0.2 million increase in telephone expense due to a change in data communications processes, a \$0.2 million increase in postage and supplies expense primarily associated with the IBT acquisition and a \$0.2 million increase in the reserve for unfunded loan commitments.

## Edgar Filing: S&T BANCORP INC - Form 10-Q

S&T's efficiency ratio, which measures noninterest expense as a percent of noninterest income plus net interest income on a fully taxable equivalent basis, excluding security gains, was 44 percent for the three months ended September 30, 2008 and 2007.

---

**Table of Contents**

**S&T BANCORP, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF**

**OPERATIONS continued**

**Federal Income Taxes**

Federal income tax expense decreased \$0.7 million or 12 percent in the third quarter of 2008 as compared to the third quarter of 2007. The effective tax rate for the third quarter of 2008 was 25 percent and 28 percent for 2007, which is below the 35 percent statutory rate due to benefits resulting from tax-exempt interest, excludable dividend income and the tax benefits associated with LIHTC and Federal Historic Tax Credit projects. S&T currently does not incur any alternative minimum tax.

**Critical Accounting Policies and Judgments**

S&T's consolidated financial statements are prepared based upon the application of certain critical accounting policies affecting accounts such as: securities, income taxes, joint ventures, allowance for loan losses, mortgage servicing rights valuations and goodwill and other intangibles. Certain of these policies require numerous estimates and strategic or economic assumptions that may prove inaccurate or subject to variations and may significantly affect S&T's reported results and financial position for the period or in future periods. Changes in underlying factors, assumptions or estimates in any of these areas could have a material impact on S&T's future financial condition and results of operations. S&T's critical accounting policies are presented in Management's Discussion and Analysis of Financial Condition and Results of Operations in S&T's Annual Report on Form 10-K, as filed with the SEC on February 29, 2008. There have been no material changes in S&T's critical accounting policies since December 31, 2007.

**Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995**

This Quarterly Report on Form 10-Q contains or incorporates statements that we believe are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements generally relate to our financial condition, results of operations, plans, objectives, future performance or business. Such statements usually can be identified by the use of forward-looking language such as will likely result, may, are expected to, is anticipated, estimate, forecast, projected, intends to or other similar words. You should not place undue reliance on these statements, as they are subject to risks and uncertainties, including but not limited to those described in this Form 10-Q or the documents incorporated by reference. When considering these forward-looking statements, you should keep in mind these risks and uncertainties, as well as any cautionary statements we may make. Moreover, you should treat these statements as speaking only as of the date they are made and based only on information then actually known to us. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

These forward-looking statements are based on current expectations, estimates and projections about S&T's business, management's beliefs and assumptions made by management. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ( Future Factors ), which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in these forward-looking statements.

Future Factors include:

changes in interest rates, spreads on earning assets and interest-bearing liabilities, the shape of the yield curve and interest rate sensitivity;

credit losses;

## Edgar Filing: S&T BANCORP INC - Form 10-Q

sources of liquidity;

legislation affecting the financial services industry as a whole, and/or S&T and its subsidiaries individually or collectively;

regulatory supervision and oversight, including required capital levels;

increasing price and product/service competition by competitors, including new entrants;

rapid technological developments and changes;

the ability to continue to introduce competitive new products and services on a timely, cost-effective basis;

the mix of products/services;

**Table of Contents**

**S&T BANCORP, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF**

**OPERATIONS continued**

containing costs and expenses;

governmental and public policy changes, including environmental regulations;

reliance on large customers;

technological, implementation and cost/financial risks in large, multi-year contracts;

the outcome of pending and future litigation and governmental proceedings;

continued availability of financing;

financial resources in the amounts, at the times and on the terms required to support our future businesses;

changes in the local economy in western-Pennsylvania area;

managing our internal growth and acquisitions in general and the integration of the recent IBT acquisition in particular;

volatility and disruption in national and international financial markets;

government intervention in the U.S. financial system; and

general economic or business conditions, either nationally or regionally, may be less favorable than expected, resulting in among other things, a reduced demand for credit and other services.

These are representative of the Future Factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions and growth rates, general economic conditions, including interest rate and currency exchange rate fluctuations, and other Future Factors.

**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

ALCO monitors and manages interest-rate sensitivity through gap, rate shock analysis and simulations in order to avoid unacceptable earnings fluctuations due to interest rate changes. S&T's gap model includes certain management assumptions based upon past experience and the expected behavior of customers. The assumptions include principal prepayments for fixed rate loans, mortgage-backed securities and collateralized mortgage obligations, and classifying the demand, savings and money market balances by degree of interest-rate sensitivity.

The gap and cumulative gap represent the net position of assets and liabilities subject to repricing in specified time periods, as measured by a ratio of rate sensitive assets to rate sensitive liabilities. The table below shows the amount and timing of repricing assets and liabilities as of September 30, 2008.

<i>(dollars in thousands)</i>	<b>Interest Rate Sensitivity September 30, 2008</b>			
	<b>1-6 Months</b>	<b>7-12 Months</b>	<b>13-24 Months</b>	<b>&gt;2 Years</b>
<b>GAP</b>				
<b>Repricing Assets:</b>				
Cash/Due From Banks	\$	\$	\$	\$ 67,872
Securities	98,262	67,601	99,645	202,071
Other Investments	29,265			
Net Loans	1,648,007	277,445	449,494	1,160,406
Other Assets				361,017
<b>Total</b>	<b>1,775,534</b>	<b>345,046</b>	<b>549,139</b>	<b>1,791,366</b>
<b>Repricing Liabilities:</b>				
Demand				600,246
NOW	27,597	27,597	55,194	110,390
Money Market	215,192			
Savings	668,845	25,143	50,286	100,572
Certificates	635,774	239,213	193,141	182,692
Repos & Short-term Borrowings	552,506			
Long-term Borrowings	142,630	20,506	75,748	42,037
Other Liabilities/Equity				495,776
<b>Total</b>	<b>2,242,544</b>	<b>312,459</b>	<b>374,369</b>	<b>1,531,713</b>
<b>Gap</b>	<b>(467,010)</b>	<b>32,587</b>	<b>174,770</b>	<b>259,653</b>
<b>Cumulative GAP</b>	<b>\$ (467,010)</b>	<b>\$ (434,423)</b>	<b>\$ (259,653)</b>	<b>\$</b>

<b>Rate Sensitive Assets/Rate Sensitive Liabilities</b>	<b>September 30, 2008</b>	<b>December 31, 2007</b>
Cumulative 6 months	0.79	0.78
Cumulative 12 months	0.83	0.81

S&T's one-year gap position at September 30, 2008 indicates a liability sensitive position. This means that more liabilities than assets will reprice during the measured time frames. The implications of a liability sensitive position will differ depending upon the change in market interest rates. For example, with a liability sensitive position in a declining interest rate environment, more liabilities than assets will decrease in rate. This situation could result in an increase to our interest rate spreads, net interest income and operating income. Conversely, with a liability sensitive position in a rising interest rate environment, more liabilities than assets will increase in rate. This situation could result in a decrease to our interest rate spreads, net interest income and operating income.





**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK continued**

In addition to the gap analysis, S&T performs rate shock analyses on a static balance sheet to estimate the effect that specific interest-rate changes would have on 12 months of pretax net interest income. The rate shock incorporates management assumptions regarding the level of interest rate changes on non-maturity deposit products (savings, money market and NOW and demand deposits) and changes in the prepayment behavior of fixed rate loans and securities with optionality. Inclusion of these assumptions makes rate shock analysis more useful than gap analysis alone. The table below shows the results of the rate shock analyses.

Change in Pretax net interest income <i>(dollars in millions)</i>	Immediate Change in Rates	
	+300 bps	-300 bps
September 30, 2008	\$ (3.1)	\$ (1.5)
December 31, 2007	\$ (4.4)	\$ (2.9)

The results in the 300 basis point shock scenario are not consistent with a liability sensitive gap position, which would indicate an increase in net interest income. This is primarily due to: (1) rates on regular savings, NOW and money market accounts lagged when short-term rates increased and cannot be decreased to any great extent as rates go down; and (2) loan refinance activity will be considerable in a rates down interest rate scenario. Since December 2007 short-term rates have decreased by 225 basis points. With interest rates at this low level, variable rate loans, short duration time deposits, core deposits, and short-term variable rate borrowings are not repriced at the full -300 basis points in shock down scenarios. As a result these variable rate assets and funding sources hit floors quickly while fixed rate assets continue to reprice at the -300 basis point rate reduction. Comparing September 2008 to December 2007, the relative improvement in net interest income in the -300 basis point shock scenario is mainly due to an increase in short-term variable wholesale funding that reprices more quickly in rates down.

Consistent with a liability sensitive gap position, the +300 rate shock results show pretax net interest income decreasing in an increasing interest rate environment. Comparing September 2008 to December 2007, the relative improvement is due to the refinement of core deposit rate change sensitivity assumptions and an increase in rate sensitive assets, offset by an increase in variable rate funding. Rate change sensitivity assumptions utilized in modeling core deposits in rate shock scenarios were refined to reflect historical experience. Historical data indicates that as market rates increase, core deposit rates did not increase as much as previously assumed.

**Item 4. CONTROLS AND PROCEDURES****Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2008. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ( Exchange Act ), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and our management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2008, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

**Table of Contents**

**S&T BANCORP, INC. AND SUBSIDIARIES**

**Item 4. CONTROLS AND PROCEDURES continued**

**Changes in Internal Control Over Financial Reporting**

There were no changes in S&T's internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the third quarter of 2008 that have materially affected, or are reasonably likely to materially affect, S&T's internal control over financial reporting.

**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

Not Applicable

**Item 1A. Risk Factors.**

Risk factors are presented in Item 1A of S&T's Annual Report on Form 10-K for the year ended December 31, 2007, as filed with the SEC on February 29, 2008. Management believes that there have been no material changes in S&T's risk factors since December 31, 2007.

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

Not Applicable

**Item 3. Defaults Upon Senior Securities.**

Not Applicable

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

Not Applicable

**Item 5. Other Information.**

Not Applicable

**Item 6. Exhibits**

**Exhibit 31.1**

## Edgar Filing: S&T BANCORP INC - Form 10-Q

Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended. Filed herewith.

### **Exhibit 31.2**

Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended. Filed herewith.

### **Exhibit 32**

Certification for Todd D. Brice, Chief Executive Officer, and Robert E. Rout, Chief Financial Officer, pursuant to Rule 13a-14(b) and Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended. Filed herewith.

**Table of Contents**

**S&T BANCORP, INC. AND SUBSIDIARIES**

**Exhibit 99.1**

The unaudited pro forma condensed consolidated financial statements of S&T and IBT as of and for the three months ended March 31, 2008 and for the year ended December 31, 2007. Filed as Exhibit 99.3 to S&T's Current Report on Form 8-K, filed on August 18, 2008 and incorporated by reference herein.

**Table of Contents**

**SIGNATURES**

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

S&T Bancorp, Inc.

(Registrant)

Date: November 5, 2008

/s/ Wendy S. Bell  
**Wendy S. Bell**  
**Chief Accounting Officer**