

S&T BANCORP INC  
Form 10-Q  
May 07, 2008  
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## 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 March 31, 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)

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**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 - 24,625,829 shares as of April 21, 2008

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**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>March 31, 2008 (Unaudited)</b>	<b>December 31, 2007 (Audited) (Note A)</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 82,352	\$ 74,879
Securities available for sale	346,513	358,822
Other investments	15,540	13,833
Loans held for sale	885	899
Portfolio loans, net of allowance for loan losses of \$35,717 at March 31, 2008 and \$34,345 at December 31, 2007	2,814,264	2,761,695
Premises and equipment, net	37,928	37,629
Goodwill	50,300	50,087
Other intangibles, net	2,490	2,461
Bank owned life insurance	35,993	35,626
Other assets	77,541	71,690
<b>Total Assets</b>	<b>\$ 3,463,806</b>	<b>\$ 3,407,621</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing demand	\$ 471,040	\$ 459,708
Interest-bearing demand	153,520	151,686
Money market	167,429	144,408
Savings	882,884	946,967
Time deposits	930,314	919,056
<b>Total Deposits</b>	<b>2,605,187</b>	<b>2,621,825</b>
Securities sold under repurchase agreements and federal funds purchased	71,391	100,258
Short-term borrowings	140,000	80,000
Long-term borrowings	200,784	201,021
Junior subordinated debt securities	45,619	25,000
Other liabilities	51,752	41,957
<b>Total Liabilities</b>	<b>3,114,733</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	26,785	27,502
Retained earnings	382,869	375,654
Accumulated other comprehensive income	6,144	2,900
Treasury stock (5,098,902 shares at March 31, 2008 and 5,162,951 shares at December 31, 2007, at cost)	(141,010)	(142,781)
<b>Total Shareholders Equity</b>	<b>349,073</b>	<b>337,560</b>
<b>Total Liabilities and Shareholders Equity</b>	<b>\$ 3,463,806</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 March 31,</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	\$ 46,802	\$ 48,732
Deposits with banks and federal funds sold	1	2
Investment securities:		
Taxable	2,625	3,071
Tax-exempt	643	661
Dividends	387	468
<b>Total Interest Income</b>	<b>50,458</b>	<b>52,934</b>
<b>INTEREST EXPENSE</b>		
Deposits	15,274	19,595
Securities sold under repurchase agreements and federal funds purchased	468	1,309
Short-term borrowings	942	762
Long-term borrowings and junior subordinated debt securities	3,225	3,059
<b>Total Interest Expense</b>	<b>19,909</b>	<b>24,725</b>
<b>NET INTEREST INCOME</b>	<b>30,549</b>	<b>28,209</b>
Provision for loan losses	1,279	2,178
<b>Net Interest Income After Provision for Loan Losses</b>	<b>29,270</b>	<b>26,031</b>
<b>NONINTEREST INCOME</b>		
Security gains, net	611	1,656
Service charges on deposit accounts	2,402	2,343
Wealth management fees	1,862	1,855
Letter of credit fees	453	466
Insurance commissions	1,997	1,894
Mortgage banking	(26)	198
Other	2,211	1,760
<b>Total Noninterest Income</b>	<b>9,510</b>	<b>10,172</b>
<b>NONINTEREST EXPENSE</b>		
Salaries and employee benefits	10,060	9,934
Occupancy, net	1,700	1,332
Furniture and equipment	960	929
Other taxes	654	758
Data processing	1,071	1,234
Marketing	691	613
Amortization of intangibles	66	81
FDIC assessment	75	76
Other	2,678	2,632
<b>Total Noninterest Expense</b>	<b>17,955</b>	<b>17,589</b>
<b>Income Before Taxes</b>	<b>20,825</b>	<b>18,614</b>
Applicable Income Taxes	5,969	5,316

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<b>Net Income</b>		<b>\$ 14,856</b>	<b>\$ 13,298</b>
<b>Earnings per common share:</b>			
Net Income Basic		\$ 0.61	\$ 0.53
Net Income Diluted		0.60	0.52
Dividends declared per common share		0.31	0.30
Average Common Shares Outstanding Basic		24,536	25,223
Average Common Shares Outstanding Diluted		24,680	25,390
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 three months ended March 31, 2007	\$ 13,298			13,298			13,298
<b>Other comprehensive income, net of tax</b>							
Change in unrealized losses on securities of (\$4,479) net of reclassification adjustment for gains included in net income of \$1,656 and reclassification adjustment of (\$983) related to Rabbi Trust and tax benefit of \$1,984.	(1,822)				(1,822)		(1,822)
<b>Comprehensive Income</b>	<b>\$ 11,476</b>						
Cash dividends declared (\$0.30 per share)				(7,474)			(7,474)
Treasury stock acquired (501,500 shares)						(16,434)	(16,434)
Treasury stock issued for stock options exercised (38,013 shares)			(212)			1,013	801
Tax benefit from nonstatutory stock options exercised			177				177
Recognition of nonstatutory stock option compensation expense			113				113
Adjustment to initially apply FIN 48				(151)			(151)
<b>Balance at March 31, 2007</b>		<b>\$ 74,285</b>	<b>\$ 26,776</b>	<b>\$ 355,120</b>	<b>\$ 2,192</b>	<b>\$ (130,814)</b>	<b>\$ 327,559</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 three months ended March 31, 2008	\$ 14,856			14,856			14,856
<b>Other comprehensive income, net of tax</b>							
Change in unrealized gains on securities of \$5,595 net of reclassification adjustment for gains included in net income of (\$611) and tax expense of (\$1,744).	3,240				3,240		3,240
<b>Comprehensive Income</b>	<b>\$ 18,096</b>						
Cash dividends declared (\$0.31 per share)				(7,641)			(7,641)
Treasury stock issued for stock options exercised (64,049 shares)			(979)			1,771	792
Recognition of restricted stock compensation expense			95				95
Tax benefit from nonstatutory stock options exercised			53				53
Recognition of nonstatutory stock option compensation expense			114				114



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Adjustment of deferred pension items					4		4
<b>Balance at March 31, 2008</b>	<b>\$ 74,285</b>	<b>\$ 26,785</b>	<b>\$ 382,869</b>	<b>\$</b>	<b>6,144</b>	<b>\$ (141,010)</b>	<b>\$ 349,073</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>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating Activities</b>		
Net Income	\$ 14,856	\$ 13,298
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,279	2,178
Depreciation and amortization	964	897
Net amortization of investment security premiums	156	250
Recognition of stock-based compensation expense	372	132
Security gains, net	(611)	(1,656)
Deferred income taxes	(1,051)	(980)
Tax benefits from stock-based compensation	5	(142)
Mortgage loans originated for sale	(3,412)	(2,916)
Proceeds from the sale of loans	3,457	3,017
Gain on the sale of loans, net	(31)	(102)
Decrease in interest receivable	662	287
(Decrease) increase in interest payable	(52)	304
Increase in other assets	(7,768)	(2,289)
Increase in other liabilities	10,340	7,892
<b>Net Cash Provided by Operating Activities</b>	<b>19,166</b>	<b>20,170</b>
<b>Investing Activities</b>		
Net decrease of interest-earning deposits with banks		30
Proceeds from maturities of securities available for sale	14,441	22,745
Proceeds from sales of securities available for sale	1,600	6,062
Purchases of securities available for sale		(1)
Net increase in loans	(53,848)	(68,336)
Purchases of premises and equipment	(1,198)	(1,703)
<b>Net Cash Used in Investing Activities</b>	<b>(39,005)</b>	<b>(41,203)</b>
<b>Financing Activities</b>		
Net (decrease) increase in core deposits	(27,896)	8,933
Net increase in time deposits	11,258	2,647
Net increase in short-term borrowings	60,000	10,000
Net decrease in securities sold under repurchase agreements and federal funds purchased	(28,867)	(28,469)
Proceeds from long-term borrowings	20,000	50,000
Repayments of long-term borrowings	(20,237)	(226)
Proceeds from junior subordinated debt securities	19,888	
Acquisition of treasury stock		(16,434)
Sale of treasury stock	792	801
Cash dividends paid to shareholders	(7,621)	(7,607)
Tax benefits from stock-based compensation	(5)	142
<b>Net Cash Provided by Financing Activities</b>	<b>27,312</b>	<b>19,787</b>
Increase (decrease) in Cash and Cash Equivalents	7,473	(1,246)
Cash and Cash Equivalents at Beginning of Period	74,879	59,980
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 82,352</b>	<b>\$ 58,734</b>

See notes to Condensed Consolidated Financial Statements



**Table of Contents****S&T BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****March 31, 2008****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 in the United States ( GAAP ) 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 United States 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 three-month period ended March 31, 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 Bancorp, Inc. and subsidiaries 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 periods ended March 31, 2008 and 2007, interest paid was \$19,684,000 and \$26,254,000, respectively. Income taxes paid during the first three months of 2008 were \$1,186,000 compared to zero 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 840,000 and 564,000 anti-dilutive stock options for the three months ended March 31, 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:

	<b>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Weighted average shares outstanding (basic)	24,535,849	25,223,326
Impact of common stock equivalents	144,635	166,258
<b>Weighted average shares outstanding (diluted)</b>	<b>24,680,484</b>	<b>25,389,584</b>



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

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

**NOTE C - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In September 2006, the Financial Accounting 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 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, the 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 will enable 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. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 157, Fair Value Measurements. S&T adopted SFAS No. 159 as of January 1, 2008. S&T elected to not expand the use of fair value under SFAS No. 159.

In July 2007, the AICPA issued Statement of Position 07-1, Clarification of the Scope of the Audit and Accounting Guide for Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies (SOP 07-1), which was expected to be effective for fiscal years beginning on or after December 15, 2007. However, the FASB has recently voted to delay the effective date indefinitely. The proposal to delay the effectiveness will be exposed for a 30-day comment period. SOP 07-1 sets forth more stringent criteria for qualifying as an investment company than does the predecessor Audit Guide. In addition, SOP 07-1 establishes new criteria for a parent company or equity method investor to retain investment company accounting in their consolidated financial statements. Investment companies record all their investments at fair value with changes in value reflected in earnings. S&T is currently evaluating the potential impact of adopting SOP 07-1.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations, and SFAS No. 160, Noncontrolling Interest in Consolidated Financial Statements. SFAS No. 141R and SFAS No. 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 No. 141R and SFAS No. 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 No. 141R and SFAS No. 160 on S&T's financial position and results of operations.

**NOTE D - 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.

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

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued**

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*.

This hierarchy 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.

If quoted market prices are not available, fair value is based upon internally developed valuation techniques that use, where possible, current market-based or independently sourced market parameters, such as interest rates. Items valued using such internally generated 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.

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 include observable inputs rather than significant unobservable inputs and therefore fall 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, methodology includes broker quotes, proprietary models, vast descriptive terms and conditions databases, as well as extensive quality control programs.

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 included 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.

**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.



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

**Mortgage servicing rights**

On January 1, 2007, S&T adopted fair-value accounting under SFAS No. 156 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.

These MSRs, which totaled \$1,669,000 as of March 31, 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. S&T considers counterparty and its own credit risk and collateral in the determination of fair value, if material. 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 March 31, 2008.

<i>(dollars in thousands)</i>	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Securities available for sale	\$ 32,586	\$ 313,177	\$ 750	\$ 346,513
Trading account assets	3,925			3,925
Mortgage servicing rights			1,669	1,669
Interest rate swaps		9,170		9,170
<b>Total Assets</b>	<b>\$ 36,511</b>	<b>\$ 322,347</b>	<b>\$ 2,419</b>	<b>\$ 361,277</b>

**Liabilities**

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Interest rate swaps	\$ 9,170	\$ 9,170
<b>Total Liabilities</b>	<b>\$ 9,170</b>	<b>\$ 9,170</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 three month period ended March 31, 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 March 31, 2008
<b>Assets</b>					
Securities available for sale <sup>(1)</sup>	\$ 750	\$	\$	\$	\$ 750
Mortgage servicing rights <sup>(2)</sup>	1,861	(48)	(144)		1,669

(1) 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 security gains (losses) net on the Consolidated Statements of Income.

(2) Unrealized gains (losses) on MSRs are recorded in mortgage banking on the Consolidated Statements of Income.

**NOTE E - MORTGAGE LOAN SERVICING**

Mortgage servicing assets are recognized as separate assets when servicing rights are acquired through loan originations when the underlying loan is sold. Upon sale, the mortgage servicing right is established, which represents the then current market value of future net cash flows expected to be realized for performing the servicing activities. The market value of the mortgage servicing rights 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 mortgage servicing rights. Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced. In determining the market value of the mortgage servicing rights, mortgage interest rates, which are used to determine prepayment rates and discount rates, are held constant over the estimated life of the portfolio. Capitalized mortgage servicing rights 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 mortgage servicing rights are regularly evaluated for impairment based on the estimated market value of those rights. The mortgage servicing rights 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.

Mortgage servicing rights 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 mortgage servicing rights. Unlike a valuation allowance, a direct write-down permanently reduces the carrying value of the mortgage servicing rights and the valuation allowance, precluding subsequent recoveries.

For the three months ended March 31, 2008 and 2007, the 1-4 family mortgage loans that were sold to Fannie Mae amounted to \$3.5 million and \$3.0 million, respectively. At March 31, 2008 and 2007, gross mortgage servicing rights were \$2.0 million and \$2.1 million, respectively. The fair market value of mortgage servicing rights was \$1.7 million and \$2.0 million at March 31, 2008 and 2007, respectively. At March 31, 2008 and 2007, S&T's servicing portfolio totaled \$177.5 million and \$179.5 million, respectively.



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

The following table presents changes in mortgage servicing rights at March 31:

<i>(dollars in thousands)</i>	<b>Servicing Rights</b>	<b>Valuation Allowance</b>	<b>Net Carrying Value</b>
<b>Balance at January 1, 2008</b>	<b>\$ 2,017</b>	<b>\$ 156</b>	<b>\$ 1,861</b>
Additions/(reductions)	37	144	(107)
Amortization	(85)		(85)
<b>Balance at March 31, 2008</b>	<b>\$ 1,969</b>	<b>\$ 300</b>	<b>\$ 1,669</b>

<i>(dollars in thousands)</i>	<b>Servicing Rights</b>	<b>Valuation Allowance</b>	<b>Net Carrying Value</b>
<b>Balance at January 1, 2007</b>	<b>\$ 2,124</b>	<b>\$ 56</b>	<b>\$ 2,068</b>
Additions/(reductions)	37	(13)	50
Amortization	(81)		(81)
<b>Balance at March 31, 2007</b>	<b>\$ 2,080</b>	<b>\$ 43</b>	<b>\$ 2,037</b>

**NOTE F - EMPLOYEE BENEFITS**

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

<i>(dollars in thousands)</i>	<b>Three months ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Service cost - benefits earned during the period	\$ 468	\$ 501
Interest cost on projected benefit obligation	811	739
Expected return on plan assets	(1,296)	(1,233)
Net amortization and deferral	4	4
<b>Net Periodic Pension (Benefit) Expense</b>	<b>\$ (13)</b>	<b>\$ 11</b>

S&T previously disclosed in its financial statements for the year ended December 31, 2007, that S&T made no contributions to its pension plan in December 2007 for 2008. No further 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 G - SECURITIES**

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

**March 31, 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	\$ 134,023	\$ 3,414	\$	\$ 137,437
Collateralized mortgage obligations of U.S. government corporations and agencies	57,187	1,097		58,284
Mortgage-backed securities	26,947	175	(156)	26,966
Obligations of state and political subdivisions	78,434	714	(15)	79,133
<b>Debt securities available for sale</b>	<b>296,591</b>	<b>5,400</b>	<b>(171)</b>	<b>301,820</b>
Marketable equity securities	32,167	10,901	(2,731)	40,337
Other securities	4,356		&n	