

Stock Yards Bancorp, Inc.
Form 10-K
February 28, 2019

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

Form 10-K

**Annual Report Pursuant to Section 13
or 15(d) of the Securities Exchange Act of 1934**

**For the Fiscal Year Ended Commission File Number
December 31, 2018 1-13661**

STOCK YARDS BANCORP, INC.

**1040 East Main Street
Louisville, Kentucky 40206
(502) 582-2571**

Incorporated in Kentucky I.R.S. No. 61-1137529

Securities registered pursuant to Section 12(b) of the Act:

Title of each class: *Name of each exchange on which registered:*
Common Stock, no par value NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

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None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes
No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

The aggregate market value of registrant's voting stock held by non-affiliates of the registrant as of June 30, 2018 (the last business day of the registrant's most recently completed second fiscal quarter) was \$786,898,457.

The number of shares of the registrant's Common Stock, no par value, outstanding as of February 22, 2019, was 22,791,883.

Documents Incorporated By Reference

Portions of Registrant's definitive proxy statement related to Registrant's Annual Meeting of Shareholders to be held on April 25, 2019 (the "Proxy Statement"), to be filed with the Securities and Exchange Commission, are incorporated by reference into Part III of this Form 10-K.

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Glossary of Acronyms and Terms

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

| | |
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| Allowance | Allowance for loan and lease losses |
| ASU | Accounting Standards Update |
| Bancorp | Stock Yards Bancorp, Inc. |
| Bank | Stock Yards Bank & Trust Company |
| BOLI | Bank Owned Life Insurance |
| BP | Basis Point = 1/100 th of one percent |
| CEO | Chief Executive Officer |
| COSO | Committee of Sponsoring Organizations |
| CRA | Community Reinvestment Act of 1977 |
| Dodd-Frank Act | Dodd-Frank Wall Street Reform and Consumer Protection Act |
| EPS | Earnings Per Share |
| EVP | Executive Vice President |
| FASB | Financial Accounting Standards Board |
| FDIC | Federal Deposit Insurance Corporation |
| FHC | Financial Holding Company |
| FHLB | Federal Home Loan Bank |
| FHLMC | Federal Home Loan Mortgage Corporation |
| FNMA | Federal National Mortgage Association |
| GLB Act | Gramm-Leach-Bliley Act |
| GNMA | Government National Mortgage Association |
| KING | King Bancorp, Inc. |
| KSOP | Combined employee profit sharing and stock ownership plan |
| LIBOR | London Interbank Offered Rate |
| MSA | Metropolitan Statistical Area |
| MSR | Mortgage Servicing Right |
| OAEM | Other Assets Especially Mentioned |
| Oldham | THE BANCORP, Inc. |
| OREO | Other Real Estate Owned |
| OTTI | Other-Than-Temporary Impairment |
| Prime | Wall Street Journal Prime Rate |
| Provision | Provision for loan and lease losses |
| PSU | Performance Stock Unit |
| RSU | Restricted Stock Unit |
| SAR | Stock Appreciation Right |
| SEC | Securities and Exchange Commission |
| SVP | Senior Vice President |
| TDRs | Troubled Debt Restructurings |
| US GAAP | United States Generally Accepted Accounting Principles |

WM&T Wealth Management and Trust

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Part I

Item 1. Business

Stock Yards Bancorp, Inc. (“Bancorp” or “Company”), headquartered in Louisville, Kentucky, is the holding company for Stock Yards Bank & Trust Company (“Bank”). Bancorp, which was incorporated in 1988 in Kentucky, is registered with, and subject to supervision, regulation and examination by, the Board of Governors of the Federal Reserve System. The Bank is wholly owned and is a state chartered bank. Because Bancorp has no significant operations of its own, its business and that of the Bank are essentially the same. The operations of the Bank are fully reflected in the consolidated financial statements of Bancorp. Accordingly, references to “Bancorp” in this document may encompass both the holding company and the Bank.

Stock Yards Bank & Trust Company

Stock Yards Bank & Trust Company is the banking and sole subsidiary of Bancorp and was chartered in 1904. The Bank is headquartered in Louisville, Kentucky and provides commercial and personal banking services in the Louisville, Kentucky, Indianapolis, Indiana and Cincinnati, Ohio metropolitan markets through 38 full service banking offices. The Bank is chartered under the laws of the Commonwealth of Kentucky. In addition to traditional commercial and personal banking activities, the Bank has a wealth management and trust department (“WM&T”) offering a wide range of investment management, trust, employee benefit plan, estate administration, and financial planning services. The Bank also originates and sells single-family residential mortgages. Additionally, the Bank offers securities brokerage services via its branch network through an arrangement with a third party broker-dealer.

At December 31, 2018, Stock Yards Bank & Trust Company had 591 full-time equivalent employees. Employees of Stock Yards Bank & Trust Company are entitled to participate in a variety of employee benefit programs including a combined employee profit sharing and stock ownership plan (“KSOP”). Management of Bancorp strives to be an employer of choice and considers the relationship with employees to be good.

Supervision and Regulation

Bank holding companies and commercial banks are extensively regulated under both federal and state laws. Changes in applicable laws or regulations may have a material effect on the business and prospects of Bancorp.

Bancorp, as a registered bank holding company, is subject to the supervision of and regulation by the Federal Reserve Board under the Bank Holding Company Act of 1956. In addition, Bancorp is subject to the provisions of Kentucky's banking laws regulating bank acquisitions and certain activities of controlling bank shareholders.

Kentucky and federal banking statutes delineate permissible activities for Kentucky state-chartered banks. Kentucky's statutes, however, contain a super parity provision for Kentucky chartered banks having one of the top two ratings in its most recent regulatory examination. This provision allows these state banks to engage in any banking activity in which a national bank, a state bank operating in any other state, or a federally chartered thrift could engage. The bank must first obtain a legal opinion specifying the statutory or regulatory provisions that permit the activity.

The Bank is subject to the supervision of the Kentucky Department of Financial Institutions and the Federal Deposit Insurance Corporation. The Federal Deposit Insurance Corporation ("FDIC") insures the deposits of the Bank to the current maximum of \$250,000 per depositor.

The Gramm-Leach-Bliley Act (the "GLB Act") allows for affiliations among banks, securities firms and insurance companies by means of a financial holding company ("FHC"). The GLB Act requires that, at the time of establishment of an FHC, all depository institutions within that corporate group must be "well managed" and "well capitalized" and must have received a rating of "satisfactory" or better under its most recent Community Reinvestment Act examination. Further, non-banking financial firms (for example an insurance company or securities firm) may establish a FHC and acquire a depository institution. While the distinction between banks and non-banking financial firms has been blurring over recent years, the GLB Act makes it less cumbersome for banks to offer services "financial in nature" but beyond traditional commercial banking activities. Likewise, non-banking financial firms may find it easier to offer services that had, heretofore, been provided primarily by depository institutions. In 2012, management of Bancorp elected to become and became a FHC.

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The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) was signed into law in 2010. Generally, the Dodd-Frank Act was effective the day after it was signed into law, but different effective dates apply to specific sections of the law. This extensive and complex legislation contained many provisions affecting the banking industry, including but not limited to:

Creation of a Bureau of Consumer Financial Protection overseeing banks with assets totaling \$10 billion or greater while writing and maintaining several regulations that apply to all banks,
Determination of debit card interchange rates by the Federal Reserve Board,
New regulation over derivative instruments,
Phase outs of certain forms of trust preferred debt and hybrids previously included as bank capital, and
Increases to FDIC deposit coverage, revised calculations for assessing bank premiums, and numerous other provisions affecting financial institution regulation, oversight of certain non-banking organizations, investor protection.

The Community Reinvestment Act of 1977 (“CRA”) requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate-income individuals and communities. Depository institutions are periodically examined for compliance with the CRA, and banking regulators take into account CRA ratings when considering approval of certain applications. An unsatisfactory CRA rating could, among other things, result in the denial or delay of corporate applications filed by Bancorp or the Bank for proposed activities such as branch openings or relocations and applications to acquire, merge or consolidate with another banking institution or holding company.

The federal banking regulators have adopted rules limiting the ability of banks and other financial institutions to disclose non-public information about consumers to unaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to an unaffiliated third party. These regulations affect how consumer information is conveyed to outside vendors. The Bank is also subject to regulatory guidelines establishing standards for safeguarding customer information. These guidelines describe the federal banking agencies’ expectations for the creation, implementation and maintenance of an information security program, which would include administrative, technical and physical safeguards appropriate to the size and complexity of the institution and the nature and scope of its activities.

The Bank is subject to the Bank Secrecy Act and the USA Patriot Act. These statutes and related rules and regulations impose requirements and limitations on specified financial transactions and accounts and other relationships intended to guard against money laundering and terrorism financing. Financial institutions must take certain steps to assist government agencies in detecting and preventing money laundering and report certain types of suspicious transactions. Regulatory authorities routinely examine financial institutions for compliance with these obligations, and failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with relevant laws or regulations, could have serious legal and reputational consequences for the institution, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not

required.

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

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

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The rules also established a “capital conservation buffer” of 2.5%, to be phased in over three years between 2016 and 2019, above the regulatory minimum risk-based capital ratios, and will result in the following minimum ratios once the capital conservation buffer is fully phased in:

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

The capital conservation buffer requirement began being phased in January 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if capital levels fall below minimum levels plus the capital conservation buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Under these rules, Tier 1 capital generally consists of common stock (plus related surplus) and retained earnings, limited amounts of minority interest in the form of additional Tier 1 capital instruments, and non-cumulative preferred stock and related surplus, subject to certain eligibility standards, less goodwill and other specified intangible assets and other regulatory deductions. The definition of Tier 2 capital is generally unchanged for most banking organizations, subject to certain new eligibility criteria.

Common equity Tier 1 capital generally consists of common stock, additional paid-in capital and retained earnings plus limited amounts of minority interest in the form of common stock, less goodwill and other specified intangible assets and other regulatory deductions.

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

As of December 31, 2018, Bancorp met the requirements to be considered well-capitalized and is not subject to limitations due to the capital conservation buffer.

Available Information

Bancorp files reports with the Securities and Exchange Commission (“SEC”) including the Annual Report on Form 10-K, quarterly reports on Form 10-Q, current event reports on Form 8-K, and proxy statements, as well as any amendments to those reports. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>. Bancorp’s Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act are also accessible at no cost on Bancorp’s web site at <http://www.syb.com> after they are electronically filed with the SEC.

Item 1A. Risk Factors

Investment in Bancorp’s common stock involves risk, and Bancorp’s profitability and success may be affected by a number of factors including those discussed below.

Financial condition and profitability depend significantly on local and national economic conditions.

The Company’s success depends on general economic conditions both locally and nationally. Most of Bancorp’s customers are in the Louisville, Indianapolis, and Cincinnati metropolitan areas. Compared to regional or national financial institutions, Bancorp is less able to spread risks of unfavorable local economic conditions across a large number of diversified economies. Some of Bancorp’s customers are directly impacted by the local economy while others have more national or global business dealings. Deterioration in the quality of the credit portfolio could have a material adverse effect on financial condition, results of operations, and ultimately capital.

Financial condition and profitability depend on real estate values in the Company’s market area.

Bancorp offers a variety of secured loans, including commercial lines of credit, commercial term loans, real estate, construction, home equity, consumer and other loans. Bancorp’s loans are typically secured by real estate (both residential and commercial) primarily in Bancorp’s market areas. In instances where borrowers are unable to repay their loans and there has been deterioration in the value of loan collateral, Bancorp could experience higher loan losses which could have a material adverse effect on financial condition, and results of operations.

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If actual loan losses are greater than Bancorp's assumption for loan losses, earnings could decrease.

Bancorp's loan customers may not repay their loans according to the terms of these loans, collateral securing payment of these loans may be insufficient to ensure repayment and the wealth of guarantors providing guarantees to support these loans may be insufficient to aid in the repayment of these loans. Accordingly, Bancorp might experience significant credit losses which could have a material adverse effect on operating results. Bancorp makes various assumptions and judgments about collectability of the loan portfolio, including creditworthiness of borrowers and value of collateral for repayment of many loans. In determining the adequacy of the allowance for loan and lease losses ("allowance"), Bancorp considers, among other factors, an evaluation of economic conditions and Bancorp's loan loss experience. If Bancorp's assumptions prove to be incorrect or economic problems are worse than projected, the current allowance may be insufficient to cover loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in the loan portfolio. Such additions to the allowance, if necessary, could have a material adverse impact on financial results.

Federal and state regulators annually review Bancorp's allowance and may require an increase in the provision for loan losses or loan charge-offs. If regulatory agencies require any increase in the provision for loan losses or loan charge-offs for which Bancorp had not allocated, it would have a negative effect on financial results.

Fluctuations in interest rates could reduce profitability.

Bancorp's primary source of income is from net interest spread, the difference between interest earned on loans and investments and interest paid on deposits and borrowings. Bancorp expects to periodically experience gaps in interest rate sensitivities of Bancorp's assets and liabilities, meaning that either interest-bearing liabilities will be more sensitive to changes in market interest rates than interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to Bancorp's position, this gap will work against Bancorp and earnings will be negatively affected.

Many factors affect fluctuation of market interest rates, including, but not limited to the following:

- inflation or deflation
- recession
- a rise in unemployment
- tightening money supply
- international disorder and instability in foreign financial markets
- the Federal Reserve's actions to control interest rates

The Federal Reserve increased the overnight federal funds rate four times in 2018 which led to the Wall Street Journal Prime lending rate (“Prime”) increasing from 4.50% to 5.50%. Bancorp typically benefits from a rising interest rate environment, as the majority of the Company’s variable rate loans are tied to Prime with a lesser amount tied to the London Interbank Offering Rate (“LIBOR”). While variable rate loans have re-priced at higher rates Bancorp has also increased deposit rates in response to market pressure and funding needs. Deposit rates generally do not reprice as quickly as loans which positively affects earnings as rates rise in the short term. Market expectations are for the Federal Reserve to leave the federal funds rate at 5.50% for the duration of 2019. In addition, a flattening yield curve is widely anticipated, with the possibility of short term rates at some point exceeding longer term rates, resulting in an inverted yield curve. Deposit rates tend to be tied to the short end of the rate curve, while fixed-rate loans are largely priced based upon longer term rates, specifically five-year offerings. A flattening or inverted yield curve may increase Bancorp’s funding costs while limiting rates that can be earned on loans and investments, thereby decreasing net interest income and earnings. Migration of deposits out of Bancorp, as customers pursue higher rates, could impact liquidity and earnings as Bancorp competes for deposits. Changes in the mix of deposits could result in increased average rates paid on deposits, and lower earnings to Bancorp. Bancorp’s asset-liability management strategy, which is designed to mitigate risk from changes in market interest rates, may not be able to prevent changes in interest rates from having a material adverse effect on Bancorp’s results of operations and financial condition. Bancorp’s most recent earnings simulation model estimating the impact of changing interest rates on earnings for the next 12 months indicates net interest income will increase approximately 6% if interest rates immediately increase 200 basis points and decrease approximately 13% if rates immediately decrease 200 basis points. In 2019 Bancorp anticipates completing the purchase of King Bancorp, Inc., which will further add to funding pressure and could result in higher rates paid on deposits.

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Bancorp is subject to funding risk.

Funding risk represents dependence Bancorp has on large commercial deposit relationships. Approximately 40% of Bancorp's total deposits are centralized in accounts with balances \$500,000 or greater. Bancorp considers these deposits core funds as they represent long-standing, full-service relationships and are a testament to Bancorp's commitment to partner with business clients by providing exemplary service and competitive products. A sudden shift in customer behavior within these deposits resulting in balances being reduced or moved out of the Bank altogether could impact Bancorp's ability to capitalize on growth opportunities and meet current obligations. Bancorp has secondary sources of funding to draw upon as needed but the cost of those funds would be higher than typical deposit accounts which would negatively impact the financial condition and results of operation.

Significant stock market volatility could negatively affect Bancorp's financial results.

Income from WM&T constitutes approximately 47% of non-interest income. Trust assets under management are expressed in terms of market value, and a significant portion of fee income is based upon those values. A large majority of WM&T fees are based on market values which generally fluctuate with overall capital markets.

Capital and credit markets experience volatility and disruption from time to time. These conditions place downward pressure on credit availability, credit worthiness and customers' inclinations to borrow. Prolonged volatility or a significant disruption could negatively impact customers' ability to seek new loans or to repay existing loans. Personal wealth of many borrowers and guarantors has historically added a source of financial strength to certain loans and would be negatively impacted by severe market declines. Sustained reliance on personal assets to make loan payments would result in deterioration of their liquidity, and could result in loan defaults.

Competition with other financial institutions could adversely affect profitability.

Bancorp operates in a highly competitive industry that could become even more so as a result of earnings pressure of peer organizations, legislative, regulatory and technological changes and continued consolidation. Bancorp faces vigorous competition in price and structure of financial products from banks and other financial institutions. In recent years, credit unions have expanded their lending mix and now compete heavily with banks in the commercial real estate market. Non-traditional providers high risk tolerance for fixed rate, long-term loans has adversely affected Bancorp's net loan growth and results of operations. Bancorp also competes with other non-traditional providers of financial services, such as brokerage firms and insurance companies. As internet-based financial services continue to grow in acceptance, Bancorp must remain relevant as a place where consumers and businesses value personal service while other institutions offer these services without human interaction. The variety of sources of competition may reduce or limit margins on banking services, reduce market share and adversely affect results of operations and

financial condition.

An extended disruption of vital infrastructure could negatively impact Bancorp's business, results of operations, and financial condition.

Bancorp's operations depend upon, among other things, infrastructure, including equipment and facilities. Extended disruption of vital infrastructure by fire, power loss, natural disaster, telecommunications failure, information systems breaches, terrorist activity or the domestic and foreign response to such activity, or other events outside of Bancorp's control could have a material adverse impact on the financial services industry, the economy as a whole, and on Bancorp's business, results of operations and financial condition. Bancorp's business continuity plan may not work as intended or may not prevent significant interruption of operations. Occurrence of any failures or interruptions of information systems could damage Bancorp's reputation, result in loss of customer business, subject the Company to additional regulatory scrutiny, or expose Bancorp to civil litigation and possible financial liability, any of which could have an adverse effect on Bancorp's financial condition and results of operations.

Security breaches or incidences of fraud could negatively impact Bancorp's business, results of operations, and financial condition.

Bancorp's assets which are at risk for cyber-attacks include financial assets and non-public information belonging to customers. Cyber security risks include cyber espionage, blackmail, ransom, theft, and corporate account takeovers. Bancorp employs many preventive and detective controls to protect its assets, and provides mandatory recurring information security training to all employees. Bancorp has invested in multiple preventative tools in an attempt to protect customers from cyber threats and corporate account takeover. Bancorp regularly provides educational information regarding cyber threats to customers. Bancorp utilizes multiple third-party vendors who have access to the Company's assets via electronic media. While Bancorp requires third parties, many of whom are small companies, to have similar or superior controls in place, there is no guarantee that a breach of information could not occur. Activities of the Bank that subject Bancorp to risk of fraud by customers, employees, vendors, or members of the general public include ACH transactions, wire transactions, ATM transactions, checking transactions, and loan originations. Repeated incidences of fraud or a single large occurrence would adversely impact Bancorp's reputation and results of operations.

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Bancorp’s credit metrics are currently at historically strong levels and this trend could normalize over time.

During 2018, Bancorp’s asset quality metrics trended within a narrow range and exceeded benchmarks of the past several years to reach historically strong levels. Bancorp realizes that present asset quality metrics are exceptionally positive and, recognizing the cyclical nature of the lending business, the Company anticipates this trend will most likely normalize over time.

Bancorp’s accounting policies and methods are critical to how Bancorp reports its financial condition and results of operations. They require management to make estimates about matters that are uncertain.

Accounting policies and methods are fundamental to how Bancorp records and reports its financial condition and results of operations. Bancorp must exercise judgment in selecting and applying these accounting policies and methods so they comply with United States generally accepted accounting principles (“US GAAP”).

Bancorp has identified certain accounting policies as being critical because they require management’s judgment to ascertain the valuations of assets, liabilities, commitments and contingencies. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset, or reducing a liability. Bancorp has established detailed policies and control procedures intended to ensure these critical accounting estimates and judgments are well controlled and applied consistently.

Policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. Because of the uncertainty surrounding Bancorp’s judgments and estimates pertaining to these matters, there can be no assurances that actual results will not differ from those estimates. See the “Critical Accounting Policies” in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for more information.

Bancorp operates in a highly regulated environment and may be adversely affected by changes to or lack of compliance with federal, state and local laws and regulations.

Bancorp is subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal or state legislation could have a substantial impact on Bancorp and its operations. Additional legislation and regulations may be enacted or adopted in the future that could significantly affect Bancorp’s powers, authority and operations, which could have a material adverse effect on Bancorp’s financial condition and results of operations. If Bancorp’s policies, procedures and systems are deemed deficient, the Company would be subject to liability, including fines and regulatory actions, which may include restrictions on the ability to

pay dividends and the requirement to obtain regulatory approvals to proceed with certain aspects of Bancorp's business plan, including branching and acquisition plans.

Bancorp's ability to stay current on technological changes in order to compete and meet customer demands is constantly being challenged.

The financial services industry is constantly undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. Future success of Bancorp will depend, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional operational efficiencies and greater privacy and security protection for customers and their personal information. Many of Bancorp's competitors have substantially greater resources to invest in technological improvements. Bancorp may not be able to effectively implement new technology-driven products and services as quickly as competitors or be successful in marketing these products and services to its customers. Bancorp relies on third party providers for many of its technology-driven banking products and services. Some of these companies may be slow to respond with upgrades or enhancements to their products to keep pace with improvements in technology or the introduction of competing products. Failure to successfully keep pace with technological change affecting the financial services industry could impair Bancorp's ability to effectively compete to retain or acquire new business and could have an adverse impact on its business, financial position, results of operations and liquidity.

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Bancorp is dependent upon outside third parties for processing and handling of the Company's records and data.

Bancorp relies on software developed by third-party vendors to process various transactions. In some cases, Bancorp has contracted with third parties to run their proprietary software on the Company's behalf. While Bancorp performs a review of controls instituted by applicable vendors over these programs in accordance with industry standards and performs testing of user controls, the Company relies on continued maintenance of controls by these third-party vendors, including safeguards over security of client data. Bancorp may incur a temporary disruption in the Company's ability to conduct business or process transactions, or incur reputational damage, if a third-party vendor fails to adequately maintain internal controls or institute necessary changes to systems. Such a disruption or breach of security could have a material adverse effect on Bancorp's business. Further, if these third-party service providers experience difficulties, or should terminate their services, and the Company is unable to replace them on a timely basis, Bancorp's business operations could be interrupted. If an interruption were to continue for a significant period of time, or if the Company incurred excessive costs involved with replacing third-party service provider, the Company's business, financial condition and results of operations could be adversely affected.

Bancorp may not be able to attract and retain skilled people.

Bancorp's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in the industry and markets in which Bancorp engages can be intense, and the Company may not be able to retain or hire the people wanted or needed. To attract and retain qualified employees, Bancorp must compensate them at market levels. If Bancorp is unable to continue to attract and retain qualified employees, or do so at rates necessary to maintain the Company's competitive position, Bancorp's performance, including the Company's competitive position, could suffer, and, in turn, adversely affect Bancorp's business, financial condition or results of operations.

Bancorp invests in partnerships that generate federal income tax savings and these may not continue.

Bancorp invests in certain partnerships that yield federal income tax credits resulting in higher net income for Bancorp. These transactions may also include lending to developers, further enhancing profitability of the transaction. These transactions typically involve a very limited number of counterparties. Availability and suitability of these transactions are not particularly predictable and may not continue to be favorable to Bancorp. Recently enacted income tax reform could result in fewer transactions and the extent to which federal income tax credits favorably affect Bancorp's net income. Therefore the positive effect on Bancorp's net income may not continue at levels previously experienced.

Changes in customer use of banks could adversely affect Bancorp's financial condition and results of operations.

Rapid evolution of non-bank alternatives for initiation and completion of financial transactions puts Bancorp at risk of losing sources of revenue and funding. The ability of customers to pay bills, transfer funds, and purchase assets without utilizing the banking system could result in loss of fee income, deposits, and loans. If Bancorp is unable to continue timely development of competitive new products and services, its business, financial condition and results of operations could be adversely affected.

The Current Expected Credit Loss ("CECL") accounting standard will result in a significant change in how Bancorp recognizes credit losses and may have a material impact on the Company's financial condition or results of operations.

In June 2016, the Financial Accounting Standards Board issued an accounting standard update, "Financial Instruments-Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments," which replaces the current "incurred loss" model for recognizing credit losses with an "expected loss" model. Whereas the incurred loss model delays recognition of loss on financial instruments until it is probable a loss has occurred, the expected loss model will recognize a loss at the time the loan is first added to the balance sheet. As result of this differing methodology, Bancorp expects adoption of the CECL model will materially affect the determination of the allowance and could require a significant increase to the allowance. Any material increase to the required level of loan loss allowance could adversely affect Bancorp's business, financial condition, and results of operations.

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The CECL standard will become effective for Bancorp for fiscal years beginning after December 15, 2019 and for interim periods beginning with the first quarter of 2020. While the impact of implementing the CECL model cannot be quantified at this time, Bancorp expects to recognize a one-time cumulative-effect adjustment to the allowance and stockholders' equity in the first quarter of 2020. Interagency guidance issued in December 2018 allows for a three year phase-in of the cumulative-effect adjustment for regulatory capital reporting.

Company acquisitions could adversely affect Bancorp's financial condition and results of operations.

An institution that the Company acquires may have asset quality issues or contingent liabilities that the Company did not discover or fully recognize in the due diligence process, thereby resulting in unanticipated losses. Acquisitions of other institutions also typically require integration of different corporate cultures, loan and deposit products, pricing strategies, data processing systems and other technologies, accounting, internal audit and financial reporting systems, operating systems and internal controls, marketing programs and personnel of the acquired institution. The integration process is complicated and time consuming and could divert the Company's attention from other business concerns and may be disruptive to its clients and clients of the acquired institution. The Company's failure to successfully integrate an acquired institution could result in loss of key clients and employees, and prevent the Company from achieving expected synergies and cost savings.

Bancorp must transition from using LIBOR as a benchmark for loan pricing and swap transactions.

LIBOR will cease to exist as a published rate after 2021. As of December 31, 2018, Bancorp has approximately \$400 million in variable rate loans with interest rates tied to LIBOR, of which approximately \$200 million have maturity dates beyond December 31, 2021. Bancorp's derivative activities based upon LIBOR include interest rate swap transactions with maturities beyond 2021 with notional amounts totaling approximately \$56 million. The Federal Reserve through the Alternative Reference Rate Committee has recommended a replacement benchmark rate, the Secured Overnight Financing Rate. All loan and swap contracts extending beyond 2021 will need to be managed effectively to ensure appropriate benchmark rate replacements are provided for and adopted. Failure to identify a replacement benchmark rate and/or update data processing systems could result in future interest rate changes not being correctly captured, which could result in interest rate risk not being mitigated as intended, or interest earned being miscalculated, which could adversely impact Bancorp's business, financial condition, and results of operations.

Item 1B. Unresolved Staff Comments

Bancorp has no unresolved SEC staff comments.

Item 2. Properties

The principal offices of Bancorp are located at 1040 East Main Street, Louisville, Kentucky. Bancorp's operations center is at a separate location. In addition to the main office complex and the operations center, Bancorp owned 21 branch properties at December 31, 2018, two of which are located on leased land. At that date, Bancorp also leased 17 branch facilities as well as its WM&T facility. Of the 38 banking locations, 28 are located in the Louisville Metropolitan Statistical Area ("MSA"), five are located in the Indianapolis MSA and five are located in the Cincinnati MSA. See Notes 6 and 19 to Bancorp's consolidated financial statements for the year ended December 31, 2018, for additional information relating to amounts invested in premises and equipment and lease commitments.

Item 3. Legal Proceedings

See Note 19 to Bancorp's consolidated financial statements for the year ended December 31, 2018, for information relating to legal proceedings.

Item 4. Mine Safety Disclosures

Not applicable.

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Executive Officers of the Registrant

The following table lists the names and ages as of December 31, 2018 of all current executive officers of Bancorp and the Bank. Each executive officer is appointed by Bancorp’s Board of Directors to serve at the discretion of the Board.

There is no arrangement or understanding between any executive officer of Bancorp or the Bank and any other person(s) pursuant to which he/she was or is to be selected as an officer.

| Name and Age of Executive Officer | Position and Offices with Bancorp and/or the Bank |
|--|---|
| James A. Hillebrand Age 50 | Chief Executive Officer and Director of Bancorp and the Bank |
| Philip S. Poindexter Age 52 | President of Bancorp and the Bank |
| Kathy C. Thompson Age 57 | Senior Executive Vice President and Director of Bancorp and the Bank |
| Nancy B. Davis Age 63 | Executive Vice President, Treasurer and Chief Financial Officer of Bancorp and the Bank |
| William M. Dishman III Age 55 | Executive Vice President and Chief Risk Officer of the Bank |
| T. Clay Stinnett Age 45 | Executive Vice President and Chief Strategic Officer of Bancorp and the Bank |
| Michael J. Croce Age 49 | Executive Vice President and Director of Retail Banking of the Bank |
| Michael V. Rehm Age 54 | Executive Vice President, Chief Lending Officer |

Mr. Hillebrand was appointed CEO of Bancorp and the Bank in October 2018. Prior thereto, he served as President of Bancorp and the Bank since July 2008. Prior thereto, he served as Executive Vice President (“EVP”) and Director of Private Banking of the Bank since 2005. From 2000 to 2004, he served as SVP (“SVP”) of Private Banking. Mr. Hillebrand joined the Bank in 1996.

Mr. Poindexter was appointed President of Bancorp and the Bank in October 2018. Prior thereto, he served as Chief Lending Officer of the Bank since July 2008. Prior thereto, he served as EVP of the Bank and Director of Commercial Banking. Mr. Poindexter joined the Bank in 2004.

Ms. Thompson was appointed Senior EVP of Bancorp and the Bank in January 2006. Prior thereto, she served as EVP of Bancorp and the Bank. She joined the Bank in 1992 and is Manager of the Wealth Management and Trust Department.

Ms. Davis was appointed EVP of Bancorp and the Bank in 1999 and Chief Financial Officer in 1993. She joined the Bank in 1991.

Mr. Dishman joined the Bank as EVP and Chief Risk Officer in February 2009.

Mr. Stinnett was appointed EVP and Chief Strategic Officer of Bancorp and the Bank in February 2011. Prior thereto, he served as SVP and Chief Strategic Officer of the Bank since 2005. Mr. Stinnett joined the Bank in 2000.

Mr. Croce was appointed EVP of the Bank and Director of Retail Banking in July 2014. Prior thereto, he served as SVP of the Bank and Division Manager of Business Banking. Mr. Croce joined the Bank in 2004.

Mr. Rehm was appointed EVP and Chief Lending Officer of the Bank in October 2018. Prior thereto, he served as SVP of the Bank and Division Manager of Commercial Lending. Mr. Rehm joined the Bank in 2006.

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Part II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Bancorp’s common stock is traded on the NASDAQ Global Select Market under the ticker symbol SYBT. On December 31, 2018, Bancorp had approximately 1,600 shareholders of record, and approximately 5,800 beneficial owners holding shares in nominee or “street” name.

The following table shows information relating to the repurchase of shares of common stock by Bancorp during the three months ended December 31, 2018.

| | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plan | Maximum number of shares that may yet be purchased under the plan |
|--------------------------|---|---|--|--|
| October 1 - October 31 | 1,103 | \$ 31.15 | – | – |
| November 1 - November 30 | 290 | 31.73 | – | – |
| December 1 - December 31 | 190 | 32.80 | – | – |
| Total | 1,583 | \$ 31.45 | – | – |

Activity represents shares of stock withheld to satisfy employee tax obligations due upon the exercise of stock appreciation rights, on lapsed shares of restricted stock and on performance stock unit awards. Bancorp does not have an active stock repurchase program.

The following performance graphs and data shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed soliciting material or subject to Regulation 14A of the Exchange Act or incorporated by reference in any filing under the Exchange Act or the Securities Act of 1933, except as shall be expressly set forth by specific reference in such filing.

The first graph below compares performance of Bancorp Common Stock to the Russell 2000 index, the SNL Midwest Bank index, and the SNL Bank NASDAQ index for Bancorp's last five fiscal years. The graph assumes the value of the investment in Bancorp Common Stock and in each index was \$100 at December 31, 2013 and that all dividends were reinvested.

In addition to the five-year period required by the SEC, the ten-year period is presented because it provides additional perspective, and Bancorp management believes that longer-term performance is of greater interest. The ten-year graph assumes the value of the investment in Bancorp Common Stock and in each index was \$100 at December 31, 2008 and that all dividends were reinvested.

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| <i>Index</i> | <i>Period Ending</i> | | | | | |
|---------------------------|----------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | 12/31/13 | 12/31/14 | 12/31/15 | 12/31/16 | 12/31/17 | 12/31/18 |
| Stock Yards Bancorp, Inc. | \$ 100.00 | \$ 107.50 | \$ 125.12 | \$ 238.53 | \$ 195.67 | \$ 174.95 |
| Russell 2000 Index | 100.00 | 104.89 | 100.26 | 121.63 | 139.44 | 124.09 |
| SNL Midwest Bank Index | 100.00 | 108.71 | 110.36 | 147.46 | 158.46 | 135.31 |
| SNL Bank NASDAQ Index | 100.00 | 103.57 | 111.80 | 155.02 | 163.20 | 137.56 |

| <i>Index</i> | <i>Period Ending</i> | | | | | | | | | | |
|------------------------------------|----------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | 12/31/08 | 12/31/09 | 12/31/10 | 12/31/11 | 12/31/12 | 12/31/13 | 12/31/14 | 12/31/15 | 12/31/16 | 12/31/17 | 12/31/18 |
| Stock Yards Bancorp, Inc. | \$ 100.00 | \$ 80.02 | \$ 94.70 | \$ 81.85 | \$ 92.48 | \$ 135.83 | \$ 146.01 | \$ 169.94 | \$ 323.99 | \$ 264.33 | \$ 236.33 |
| Russell 2000 Index | 100.00 | 127.17 | 161.32 | 154.59 | 179.86 | 249.69 | 261.91 | 250.35 | 303.69 | 348.17 | 309.83 |
| SNL Midwest Bank Index | 100.00 | 84.75 | 105.24 | 99.40 | 119.64 | 163.80 | 178.07 | 180.78 | 241.54 | 259.56 | 221.64 |
| SNL Bank NASDAQ Index | 100.00 | 81.12 | 95.71 | 84.92 | 101.22 | 145.48 | 150.67 | 162.65 | 225.52 | 237.43 | 200.12 |

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| (In thousands except per share data and ratios) | Years ended December 31 | | | | | | | | | |
|---|--------------------------------|--------------|--------------|--------------|--------------|---|-------|---|-------|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 | | | | | |
| Income statement data | | | | | | | | | | |
| Interest income | \$ 129,773 | \$ 110,899 | \$ 102,207 | \$ 93,235 | \$ 89,112 | | | | | |
| Interest expense | 15,357 | 7,246 | 4,918 | 4,852 | 5,330 | | | | | |
| Net interest income | 114,416 | 103,653 | 97,289 | 88,383 | 83,782 | | | | | |
| Provision for loan and lease losses | 2,705 | 2,550 | 3,000 | 750 | (400) | | | | | |
| Non-interest income | 45,346 | 44,499 | 42,920 | 39,315 | 38,563 | | | | | |
| Non-interest expenses | 89,509 | 90,420 | 80,938 | 72,828 | 72,642 | | | | | |
| Income before income tax expense | 67,548 | 55,182 | 56,271 | 54,120 | 50,103 | | | | | |
| Income tax expense | 12,031 | 17,139 | 15,244 | 16,933 | 15,281 | | | | | |
| Net income | \$ 55,517 | \$ 38,043 | \$ 41,027 | \$ 37,187 | \$ 34,822 | | | | | |
| Per share data | | | | | | | | | | |
| Net income, basic | \$ 2.45 | \$ 1.69 | \$ 1.84 | \$ 1.68 | \$ 1.59 | | | | | |
| Net income, diluted | 2.42 | 1.66 | 1.80 | 1.65 | 1.57 | | | | | |
| Cash dividends declared | 0.96 | 0.80 | 0.72 | 0.64 | 0.59 | | | | | |
| Book value | 16.11 | 14.71 | 13.88 | 12.80 | 11.75 | | | | | |
| Market value | 32.80 | 37.70 | 46.95 | 25.19 | 22.23 | | | | | |
| Weighted average common and common equivalent shares - diluted | 22,944 | 22,983 | 22,792 | 22,459 | 22,144 | | | | | |
| Balance sheet data | | | | | | | | | | |
| Total assets | \$ 3,302,924 | \$ 3,239,646 | \$ 3,039,481 | \$ 2,816,801 | \$ 2,563,868 | | | | | |
| Loans | 2,548,171 | 2,409,570 | 2,305,375 | 2,033,007 | 1,868,550 | | | | | |
| Allowance | 25,534 | 24,885 | 24,007 | 22,441 | 24,920 | | | | | |
| Available for sale securities | 436,995 | 574,524 | 570,074 | 565,876 | 513,056 | | | | | |
| Deposits | 2,794,356 | 2,578,295 | 2,520,548 | 2,371,702 | 2,123,627 | | | | | |
| Federal funds purchased | 10,247 | 161,352 | 47,374 | 22,477 | 47,390 | | | | | |
| Federal Home Loan Bank advances | 48,177 | 49,458 | 51,075 | 43,468 | 36,832 | | | | | |
| Stockholders' equity | 366,500 | 333,644 | 313,872 | 286,519 | 259,895 | | | | | |
| Average balances | | | | | | | | | | |
| Stockholders' equity | 347,041 | 327,798 | 304,151 | 274,451 | 245,425 | | | | | |
| Total Assets | 3,159,726 | 3,037,581 | 2,886,396 | 2,573,901 | 2,398,430 | | | | | |
| Federal Home Loan Bank advances | 48,766 | 50,300 | 45,455 | 41,041 | 35,709 | | | | | |
| Selected ratios | | | | | | | | | | |
| Return on average assets | 1.76 | % | 1.25 | % | 1.42 | % | 1.44 | % | 1.45 | % |
| Return on average equity | 16.00 | | 11.61 | | 13.49 | | 13.55 | | 14.19 | |
| Average stockholders' equity to average assets | 10.98 | | 10.79 | | 10.54 | | 10.66 | | 10.23 | |
| Net interest rate spread | 3.60 | | 3.52 | | 3.51 | | 3.59 | | 3.67 | |
| Net interest rate margin, fully tax-equivalent | 3.83 | | 3.64 | | 3.59 | | 3.67 | | 3.75 | |
| Efficiency ratio, fully tax-equivalent | 55.92 | | 60.61 | | 57.39 | | 56.62 | | 58.91 | |

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| | | | | | |
|---------------------------------------|------|------|------|------|------|
| Non-performing loans to total loans | 0.13 | 0.31 | 0.29 | 0.44 | 0.64 |
| Non-performing assets to total assets | 0.13 | 0.31 | 0.39 | 0.48 | 0.70 |
| Net charge offs to average loans | 0.08 | 0.07 | 0.07 | 0.17 | 0.18 |
| Allowance to total loans | 1.00 | 1.03 | 1.04 | 1.10 | 1.33 |

Share and per share information has been adjusted to reflect the 3 for 2 stock-split in April 2016 effected in the form of a 50% stock dividend.

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Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Financial Section Summary

The financial section of this Form 10-K includes management’s discussion and analysis, consolidated financial statements, and the notes to those financial statements. Bancorp has prepared the following summary to assist in your review of the financial section. It is designed to give the reader an overview of Stock Yards Bancorp, Inc. and summarize some of the more important activities and events that occurred during 2018. Share and per share information has been adjusted to reflect the April 2016 3 for 2 stock-split which was effected in the form of a 50% stock dividend.

The financial section includes the following:

“Management’s discussion and analysis (“MD&A”) provides information regarding the consolidated financial condition and results of operations of Bancorp. It contains management’s view about industry trends, risks, uncertainties, accounting policies that Bancorp views as critical in light of its business and results of operations. The discussion includes key performance drivers, financial position, cash flows, commitments and contingencies, important events, transactions that have occurred over the last three years, and forward-looking information, as appropriate.

Financial statements include Consolidated Balance Sheets as of the end of the last two years, and Consolidated Statements of Income, Comprehensive Income, Changes in Stockholders’ Equity, and Cash Flows, for each of the last three years. Bancorp’s financial statements are prepared in accordance with US GAAP.

Notes to the financial statements provide insight into, and are an integral part of, the financial statements. These notes contain explanations of significant accounting policies, details about certain captions on the financial statements, information about significant events or transactions that have occurred, discussions about legal proceedings, commitments and contingencies, and selected financial information relating to business segments. Notes to the financial statements also are prepared in accordance with US GAAP.

Reports related to the financial statements and internal controls over financial reporting include the following:

- A report from BKD, LLP, an independent registered public accounting firm, which includes their opinion on the presentation of Bancorp’s consolidated financial statements in conformity with US GAAP based on their audits;
- A report from management indicating Bancorp’s responsibility for financial reporting and the financial statements;

A report from management indicating Bancorp's responsibility for the system of internal control over financial reporting, including an assessment of the effectiveness of those controls;
A report from BKD, LLP, which includes their opinion on the effectiveness of Bancorp's internal control over financial reporting; and
A report from KPMG, LLP, an independent registered public accounting firm, which includes their opinion on the presentation of Bancorp's consolidated financial statements in conformity with US GAAP based on their prior period audits.

Our Business

Stock Yards Bancorp, Inc. was incorporated in 1988, and its business is substantially the same as that of its wholly owned subsidiary, Stock Yards Bank & Trust Company. The Bank has operated continuously since it opened in 1904. The Bank conducted business at one location for 85 years and began branching in 1989. At December 31, 2018, the Bank had 28 full service banking locations in the Louisville MSA, 5 full service banking locations in the Indianapolis MSA, and 5 full service banking locations in the Cincinnati MSA. Bancorp's focus on flexible, attentive customer service has been key to its growth and profitability. The wide range of services provided by WM&T, investment product sales, and mortgage origination help support the corporate philosophy of capitalizing on full service customer relationships.

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Forward-Looking Statements

This report contains forward-looking statements under the Private Securities Litigation Reform Act that involve risks and uncertainties. These forward-looking statements may be identified by the use of words such as “expect”, “anticipate”, “plan”, “foresee”, “believe” or other words with similar meaning. Although Bancorp believes assumptions underlying forward-looking statements contained herein are reasonable, any of these assumptions could be inaccurate. Factors that could cause actual results to differ from results discussed in forward-looking statements include, but are not limited to: economic conditions both generally and more specifically in markets in which Bancorp and its subsidiary operate; competition for Bancorp’s customers from other providers of financial services; government legislation and regulation which change from time to time and over which Bancorp has no control; changes in interest rates; material unforeseen changes in liquidity, deterioration in the real estate market, results of operations or financial condition of Bancorp’s customers; or other risks detailed in Bancorp’s filings with the Securities and Exchange Commission and Item 1A of this Form 10-K, all of which are difficult to predict and many of which are beyond the control of Bancorp. Additionally, these forward-looking statements include, but are not limited to, statements relating to the expected timing and benefits of the proposed acquisition of King Bancorp, Inc., including future financial and operating results, cost savings, enhanced revenues, and accretion/dilution to reported earnings that may be realized from the acquisition, as well as other statements of expectations regarding the acquisition and other statements of goals, intentions and expectations; statements regarding its business plan and growth strategies; statements regarding the asset quality of King Bancorp’s loan and investment portfolios; and estimates of King Bancorp’s risks and future costs and benefits, whether with respect to the acquisition or otherwise.

Critical Accounting Policies

Bancorp has prepared consolidated financial information in this report in accordance with US GAAP. In preparing the consolidated financial statements, Bancorp makes estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurances that actual results will not differ from those estimates.

Management has identified the accounting policy related to the allowance and provision for loan and lease losses (“provision”) as critical to the understanding of Bancorp’s results of operations and discussed this conclusion with the Audit Committee of the Board of Directors. Since application of this policy requires significant management assumptions and estimates, it could result in materially different amounts to be reported if conditions or underlying circumstances were to change. The provision reflects an allowance methodology driven by risk ratings, historical losses, specific loss allocations, and qualitative factors. Assumptions include many factors such as changes in borrowers’ financial condition which can change quickly or historical loss ratios related to certain loan portfolios which may or may not be indicative of future losses. In the first quarter of 2018, Bancorp extended the historical period used to capture Bancorp’s historical loss ratios from 28 quarters to 32 quarters. This extension of the historical period was applied to all classes and segments of the loan portfolio. The expansion of the look-back period for the quantitative historical loss rate caused Bancorp to review the overall methodology for the qualitative factors to ensure

the Company was appropriately capturing the risk not addressed in the quantitative historical loss rate. Management believes the extension of the look-back period is appropriate to capture the impact of a full economic cycle and more accurately represents the current level of risk inherent in the loan portfolio.

The quarterly allowance calculation has both quantitative and qualitative factors which support the total balance of the allowance at period end. By extending the look-back period to 32 quarters to capture historical loss data for a full economic cycle, the allowance level increased approximately \$1.3 million compared with a 28 quarter look-back period as of March 31, 2018. The change in methodology was consistent with management's judgment regarding risk in the loan portfolio and consistent with internal analysis showing continued strong asset quality related not only in the Company's loan portfolio, but the Bank's peer group as well, validating continuation of the current economic cycle and thus the reasoning to extend the look-back period. Management will continue to evaluate appropriateness of the look-back period based on the status of the economic cycle. To the extent that management's assumptions prove incorrect, results from operations could be materially affected by a higher or lower provision for loan losses. The accounting policy related to the allowance is applicable to the commercial banking segment of Bancorp. The impact and any associated risks related to this policy on Bancorp's business operations are discussed in the "allowance for loan and lease losses" section below.

The allowance is management's estimate of probable losses inherent in the loan portfolio as of the balance sheet date. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Bancorp's allowance calculation includes allocations to loan portfolio segments at December 31, 2018 for qualitative factors including, among other factors, local economic and business conditions in each of our primary markets, quality and experience of lending staff and management, exceptions to lending policies, levels of and trends in past due loans and loan classifications, concentrations of credit such as collateral type, trends in portfolio growth, trends in value of underlying collateral for collateral-dependent loans, effect of other external factors such as the national economic and business trends, quality and depth of the loan review function, and management's judgement of current trends and potential risks. Bancorp utilizes the sum of all allowance amounts derived as described above as the appropriate level of allowance. Changes in criteria used in this evaluation or availability of new information could cause the allowance to be increased or decreased in future periods. In addition, bank regulatory agencies, as part of their examination process, may require adjustments to the allowance based on their judgments and estimates.

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Overview of 2018

The following discussion should be read in conjunction with Bancorp's consolidated financial statements and accompanying notes and other schedules presented elsewhere in this report.

In 2018, Bancorp completed a record year of revenue growth, supported by solid asset and deposit growth. Total revenue, comprising fully tax equivalent net interest income and non-interest income, increased 8% to \$160.1 million in 2018 from \$148.9 million in 2017. Net income for the year ended December 31, 2018, was \$55.5 million or \$2.42 per diluted share compared with \$38.0 million or \$1.66 per diluted share for 2017.

Key aspects of the Company's performance for the year included:

The loan portfolio increased 6% year-over-year, helping drive interest income 17% higher in 2018, as compared with 2017;

Net interest margin rose 19 basis points in 2018, as compared with 2017, reflecting loan growth over the past year, higher yields on loans, and an increase in non-interest bearing deposits;

Credit quality metrics, which have remained at historically solid levels, improved further in 2018;

The Wealth Management and Trust Group revenue continued to grow, although that growth moderated in the fourth quarter due to the decline in the stock market; and

The effective tax rate declined consistent with federal income tax reform legislation enacted on December 22, 2017; net income for the fourth quarter of 2017 also reflected a non-cash charge of \$5.9 million or \$0.25 per diluted share to revalue the Company's net deferred tax asset.

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

As a result of record loan production, Bancorp increased the loan portfolio \$139 million, or 6%, to \$2.5 billion as of December 31, 2018. Increasing average yields on interest earning assets, along with the impact of increased volumes of loans contributed to higher interest income for 2018, as interest income increased \$18.9 million, or 17%, over the same period in 2017. Higher funding costs on deposits and borrowings, and deposit growth during 2018 resulted in increased interest expense of \$8.1 million or 112%, year over year. Bancorp benefited in recent years from historically low costs of funding, so that even modest increases in interest expense result in a significant percentage change over

prior periods. Net interest margin in 2018 increased to 3.83%, as compared with 3.64% in 2017 despite continuing pressure of a highly competitive lending environment and increasing rates paid on deposits.

Total non-interest income increased \$847 thousand, or 2% in 2018, as compared with 2017, and represented 28% of total revenues, down slightly from 30% in 2017. WM&T income, debit and credit card fees, treasury management fees, and investment products fees all increased in 2018 over 2017, with the greatest dollar increase from WM&T. WM&T represents an important part of the relationship focused philosophy of the Company and, accordingly, income from the department represents approximately 47% of total non-interest income for Bancorp. The magnitude of WM&T revenue distinguishes Bancorp from most other community banks of similar asset size and the 2018 increase reflected a rising stock market for most of the year and a strong year in terms of new WM&T clients added.

A decrease in amortization/impairment of investments in tax credit partnerships due to reduced investment opportunities resulted in lower non-interest expenses for 2018. Increases in other expenses, particularly personnel and technology costs associated with growth and operational support offset much of that decrease. Reflecting these variances, Bancorp's efficiency ratio for 2018 of 55.9% was down from 60.6% in 2017.

For the year ended December 31, 2018, Bancorp recorded a \$2.7 million provision, compared with \$2.6 million for the same period in 2017. The provision represents a charge to earnings necessary to maintain an allowance that, in management's evaluation, is adequate to provide coverage for inherent losses on outstanding loans. The provision was a reflection of continued historically strong credit quality metrics. Bancorp's allowance was 1.00% of total loans at December 31, 2018, compared with 1.03% of total loans at December 31, 2017.

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Bancorp's effective income tax rate decreased to 17.8% in 2018 from 31.1% in 2017. The decrease was largely a result of the reduction of the marginal federal tax rate from 35% to 21% effective January 1, 2018, due to the Tax Cuts and Jobs Act enacted on December 22, 2017. The tax reform also resulted in higher taxes in 2017 from a one-time \$5.9 million charge to remeasure Bancorp's net deferred tax asset. The 2017 effective tax rate included significantly more tax savings from stock-based compensation deductions and federal income tax credits. Bancorp anticipates an overall effective tax rate of approximately 18% in 2019. Bancorp invests in certain partnerships that yield federal income tax credits. The tax benefit of these investments exceeds the impairment charge associated with them, resulting in a positive impact on net income. The timing of these transactions is not predictable, and the magnitude can vary widely.

In 2017 Bancorp adopted ASU 2016-09 "Compensation – Stock Compensation Improvements to Employee Share-Based Payment Accounting". The standard requires the Company to recognize all excess tax benefits and deficiencies through the income statement as income tax expense or benefit. Under previous GAAP, any excess tax benefits were recognized in additional paid-in capital to offset current period and subsequent period tax deficiencies. Bancorp recorded benefits of \$549 thousand and \$1.5 million for such tax benefits against the provision for income tax expense in 2018, and 2017, respectively.

As of December 31, 2018, the Company's total stockholders' equity to total assets was 11.10% compared with 10.30% at December 31, 2017. The Company's ratio of tangible common equity to total tangible assets was 11.05% as of December 31, 2018, compared with 10.25% at December 31, 2017. Tangible common equity (TCE), a non-GAAP measure, is a measure of a company's capital which is useful in evaluating the quality and adequacy of capital. It consists of a company's common equity less any preferred equity, less intangible assets. Tangible common equity is divided by tangible assets, which equals total assets less intangible assets. See the Non-GAAP Financial Measures section for details on reconciliation to US GAAP measures.

Challenges for 2019 will include achieving continued loan growth, managing net interest margin, managing credit quality, integrating an acquisition into the organization, and adapting to technology changes and evolving customer behavior.

Bancorp's goals for 2019 include net loan growth at a pace similar to that experienced in 2018. This will be impacted by competition, prevailing economic conditions, line of credit utilization and prepayments in the loan portfolio.

Bancorp believes there is continued opportunity for loan growth in all three of its markets, and Bancorp's ability to deliver attractive loan growth over the long-term is linked to Bancorp's success.

Bancorp expects to maintain net interest margin at a level commensurate with 2018. While Bancorp does not expect the Federal Open Market Committee to adjust rates in 2019, the yield-curve is expected to flatten and possibly invert. Management expects converting liquidity on hand in the form of cash and securities into higher earning assets to offset anticipated deposit rate increases resulting from competitive market pressure.

Bancorp has been successful at gathering sufficient deposits to fund loan growth. While deposits in all market areas have grown, the most significant increases arose in the Louisville market, particularly in time deposits. Bancorp will need to continue to increase deposits while managing deposit mix to support loan growth in all markets.

Bancorp derives significant non-interest income from WM&T services. Most of these fees are based upon the market value of assets under management (AUM). To continue growth of this income source Bancorp must attract new customers and retain existing customers. Bancorp believes there is opportunity for growth in its three markets. Growth in market values of AUM and fees is dependent upon positive returns in the overall capital markets. Bancorp has no control over market volatility.

Bancorp expects to complete the merger of King Bancorp, Inc. in 2019. Acquisitions require integration of different corporate cultures, loan and deposit products, pricing strategies, data processing systems and other technologies, accounting, internal audit and financial reporting systems, operating systems and internal controls, and marketing programs and personnel. Bancorp will need to manage the transition effectively so as to maximize retention of King's customers, integrate personnel and systems efficiently, and maximize anticipated economic benefits.

Technological advances are consistently providing opportunities for Bancorp to consider potential new products and delivery channels. Bancorp's customers' demand for innovative and relevant products and services is expected to trend along with changing technology. Bancorp will need to continue to make prudent investments in technology while managing associated risks so as to remain competitive with other financial service providers.

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

Results of Operations

Net income was \$55.5 million or \$2.42 per share on a diluted basis for 2018 compared with \$38.0 million or \$1.66 per share for 2017 and \$41.0 million or \$1.80 per share for 2016.

Net income for 2018 was positively impacted by:

- a \$10.8 million, or 10% increase in net interest income,
- a \$1.0 million, or 5% increase in WM&T income, and
- a \$5.1 million, or 30% decrease in income tax.

Net income for 2018 was negatively impacted by:

- a \$3.5 million, or 8% increase in compensation expense, and
- a \$940 thousand, or 12% increase in technology and communication expense.

The following paragraphs provide a more detailed analysis of significant factors affecting operating results.

Net Interest Income

Net interest income, the most significant component of Bancorp's earnings, represents total interest income less total interest expense. Net interest spread is the difference between the taxable equivalent rate earned on average interest earning assets and the rate expensed on average interest bearing liabilities. Net interest margin represents net interest income on a taxable equivalent basis as a percentage of average earning assets. Net interest margin is affected by both interest rate spread and the level of non-interest bearing sources of funds. The level of net interest income is determined by mix and volume of interest earning assets, interest bearing deposits and interest bearing liabilities and by changes in interest rates. The discussion that follows is based on tax-equivalent interest data.

Comparative information regarding net interest income follows:

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| (Dollars in thousands) | 2018 | 2017 | 2016 | 2018/2017 Change | 2017/2016 Change | | |
|--|-------------|-------------|-------------|---------------------|---------------------|-----|----|
| Net interest income, tax- equivalent basis | \$114,723 | \$104,446 | \$98,123 | 9.8 | % | 6.4 | % |
| Net interest spread | 3.60 | % 3.52 | % 3.51 | % 8 | bp | 1 | bp |
| Net interest margin | 3.83 | % 3.64 | % 3.59 | % 19 | bp | 5 | bp |
| Average earning assets | \$2,998,526 | \$2,872,717 | \$2,730,949 | 4.4 | % | 5.2 | % |
| Five year Treasury note rate at year end | 2.51 | % 2.20 | % 1.93 | % 31 | bp | 27 | bp |
| Average five year | | | | | | | |
| Treasury note rate | 2.75 | % 1.91 | % 1.33 | % 84 | bp | 58 | bp |
| Prime rate at year end | 5.50 | % 4.50 | % 3.75 | % 100 | bp | 75 | bp |
| Average prime rate | 4.90 | % 4.10 | % 3.51 | % 80 | bp | 59 | bp |
| One month LIBOR at year end | 2.52 | % 1.56 | % 0.77 | % 96 | bp | 79 | bp |
| Average one month LIBOR | 2.02 | % 1.11 | % 0.50 | % 91 | bp | 61 | bp |

bp = basis point = 1/100th of a percent

References above to net interest margin and net interest spread exclude the sold portion of certain participation loans from calculations. Such loans remain on Bancorp's balance sheet as required by US GAAP because Bancorp retains some form of effective control; however, Bancorp receives no interest income on the sold portion of these loans.

These participation loans sold are excluded from calculation of margins, because Bancorp believes it provides a more accurate depiction of the performance of its loan portfolio.

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Prime rate, the five year Treasury note rate and the one month LIBOR are included above to provide a general indication of the interest rate environment in which Bancorp operated. Approximately \$1 billion, or 40%, of Bancorp's loans are variable rate, of which 99% are indexed to either the Prime rate or one month LIBOR and generally reprice as those rates change. At inception, most of Bancorp's fixed rate loans are priced in relation to the five year Treasury note.

Average loan balances increased \$214 million or 9% in 2018. The Federal Reserve increased the target federal funds rate four times during the year, and rising interest rates allowed for an increase in loan yields of 36 basis points despite a competitive lending environment. Bancorp grew average interest bearing deposits \$67 million or 4%. Average interest costs on interest bearing deposits increased 38 basis points as management increased rates on certain deposit accounts during 2018. Average Federal Home Loan Bank ("FHLB") advances decreased by \$1.5 million or 3.1%, with average cost decreasing by one basis point to 1.89%.

Management anticipates net interest margins in 2019 will be similar to levels achieved in 2018 due the expected lack of rate increases from the Federal Open Market Committee, and a potential flattening or inverting yield curve. However, competitive pressures on rates for new loans could result in pressure on the net interest margin for 2019. Approximately 40% of the Company's loan portfolio is priced at variable rates, so any future rate increases will benefit this part of the portfolio. The remainder of the portfolio is priced at fixed rates. As fixed-rate loans renew and new fixed-rate loans originate, pricing could be higher, but pricing will be subject to competitive conditions, prevailing interest rates, and a flattening or possibly inverted yield curve. The margin could be affected negatively if competitive conditions for loan pricing within Bancorp's markets prevents the realization of higher fixed rates. Similarly, increased competition for deposits could result in higher rates paid on deposits, which would negatively affect net interest margin. Bancorp recognizes that higher rates paid on alternative investments available to customers will eventually force deposit interest rates to increase more quickly and severely than what has been experienced to date.

Asset/Liability Management and Interest Rate Risk

Managing interest rate risk is critical to Bancorp. The primary objective of interest rate risk management is to neutralize effects of interest rate changes on net income. By considering both on and off-balance sheet financial instruments, management evaluates interest rate sensitivity while attempting to optimize net interest income within the constraints of prudent capital adequacy, liquidity needs, market opportunities and customer requirements.

Interest Rate Simulation Sensitivity Analysis

Bancorp uses an earnings simulation model to estimate and evaluate the impact of an immediate change in interest rates on earnings in a one year forecast. The simulation model is designed to reflect dynamics of interest earning

assets and interest bearing liabilities. By estimating effects of interest rate increases and decreases, the model can reveal approximate interest rate risk exposure. This simulation model is used by management to gauge approximate results given a specific change in interest rates at a given point in time. The model is therefore a tool to indicate earnings trends in given interest rate scenarios and may not indicate actual expected results.

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The December 31, 2018 simulation analysis, which shows little interest rate sensitivity, indicates that Bancorp is asset sensitive as increases in interest rates of 100 to 200 basis points have a positive effect on net interest income. If rates immediately rise 200 basis points, net interest income would increase 5.58%. Bancorp's excess liquidity held in interest bearing deposit accounts and other short-term investments, along with variable rate loans gives the Company significant assets that will reprice as rates move. Asset balances subject to immediate repricing cause an estimated decline in net interest income in down 100 and 200 basis point rate scenarios as rates on non-maturity deposits cannot be lowered sufficiently to offset declining interest income. These estimates are summarized below.

| | Net interest income % change |
|-----------------|---|
| Increase 200 bp | 5.58 |
| Increase 100 bp | 2.79 |
| Decrease 100 bp | (1.69) |
| Decrease 200 bp | (12.89) |

Approximately 60% of Bancorp's loan portfolio has fixed rates and 40% of its loan portfolio is priced at variable rates. With the Prime rate increasing four times in 2018 to 5.50%, Bancorp's variable rate loans are beyond their floors and will reprice as rates change. This effect is captured in the simulation analysis above.

Undesignated derivative instruments described in Note 22 to Bancorp's consolidated financial statements are recognized on the consolidated balance sheet at fair value, with changes in fair value due to changes in prevailing interest rates, recorded in other non-interest income. Because of matching terms of offsetting contracts, in addition to collateral provisions which mitigate the impact of non-performance risk, changes in fair value subsequent to initial recognition have a minimal effect on earnings, and are therefore not included in the simulation analysis results above.

Derivatives designated as cash flow hedges described in Note 22 to Bancorp's consolidated financial statements are recognized on the consolidated balance sheet at fair value, with changes in fair value due to changes in prevailing interest rates, recorded net of tax in other comprehensive income.

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The following table presents the increases in net interest income due to changes in rate and volume computed on a tax-equivalent basis and indicates how net interest income in 2018 and 2017 was impacted by volume increases and the higher average interest rate environment. Tax-equivalent adjustments are based on a federal income tax rate of 21% in 2018 and 35% in 2017 and 2016. The change in interest due to both rate and volume has been allocated to the change due to rate and the change due to volume in proportion to the relationship of the absolute dollar amounts of the change in each.

Taxable Equivalent Rate/Volume Analysis

| (In thousands) | 2018/2017 Increase (decrease) due to Net | | 2017/2016 Increase (decrease) due to Net | | | |
|---|---|----------------|---|----------------|---------------|----------------|
| | Rate | Volume | Rate | Volume | Rate | Volume |
| | change | change | change | change | change | change |
| Interest income | | | | | | |
| Loans | \$18,352 | \$8,559 | \$9,793 | \$8,096 | \$1,866 | \$6,230 |
| Federal funds sold and interest bearing due from banks | (23) | 654 | (677) | 839 | 714 | 125 |
| Mortgage loans held for sale | (25) | 35 | (60) | (46) | 24 | (70) |
| Securities | | | | | | |
| Taxable | 636 | 1,205 | (569) | (86) | 142 | (228) |
| Tax-exempt | (552) | (151) | (401) | (152) | 79 | (231) |
| Total interest income | 18,388 | 10,302 | 8,086 | 8,651 | 2,825 | 5,826 |
| Interest expense | | | | | | |
| Deposits | | | | | | |
| Interest bearing demand deposits | 2,434 | 2,312 | 122 | 596 | 540 | 56 |
| Savings deposits | 132 | 122 | 10 | 132 | 127 | 5 |
| Money market deposits | 2,789 | 2,942 | (153) | 1,263 | 1,172 | 91 |
| Time deposits | 2,111 | 1,813 | 298 | 41 | 129 | (88) |
| Securities sold under agreements to repurchase | 23 | 39 | (16) | (2) | (17) | 15 |
| Federal funds purchased and other short-term borrowings | 653 | 302 | 351 | 106 | 117 | (11) |
| Federal Home Loan Bank advances | (31) | (2) | (29) | 192 | 106 | 86 |
| Total interest expense | 8,111 | 7,528 | 583 | 2,328 | 2,174 | 154 |
| Net interest income | \$10,277 | \$2,774 | \$7,503 | \$6,323 | \$651 | \$5,672 |

Bancorp's tax equivalent net interest income increased \$10.3 million for the year ended December 31, 2018 compared with the same period of 2017, while 2017 increased \$6.3 million compared with 2016.

Overall, net interest income for the comparative periods was positively impacted by an increase in the average rate earned on assets, which exceeded the increase in the average cost of deposits, and by an increase in non-interest bearing deposits. As shown in the table above, net interest income for 2018 compared with 2017 was positively impacted, most significantly by an increase in loan volume and interest rates earned on loans. Interest rates earned on taxable securities also positively impacted net interest income. Declines in balances of all earning asset categories aside from loans negatively impacted net interest income. Increases in rates paid on deposits and federal funds purchased and other short-term borrowings also negatively impacted net interest income.

For the year 2017 compared with 2016, net interest income was positively impacted, most significantly by an increase in loan volume and to a lesser extent interest rates earned on loans. Investments in federal funds sold and interest bearing due from banks volume and rates positively impacted net interest income. Declines in securities volumes, increased rates paid on deposit balances, and increased rates paid on federal funds purchased, other short-term borrowings, and FHLB advances negatively impacted net interest income. Overall net interest income for the comparative periods was positively impacted by an increase in the average rate earned on assets, which exceeded the increase in the average rate paid on deposits.

Table of Contents**Provision for Loan and Lease Losses**

In determining the provision, management considers many factors. Among these are the quality of the loan portfolio, underlying collateral, previous loss experience, size and composition of the loan portfolio and an assessment of the impact of current economic conditions on borrowers' ability to pay. The provision for years ended 2018, 2017, and 2016, along with resulting ratios are summarized below:

| (Dollars in thousands) | 2018 | 2017 | 2016 |
|--|---------|---------|---------|
| Provision (credit) for loan and lease losses | \$2,705 | \$2,550 | \$3,000 |
| Allowance to loans at year end | 1.00 % | 1.03 % | 1.04 % |
| Allowance to average loans for year | 1.01 | 1.08 | 1.11 |

The provision represents a charge to earnings necessary to maintain an allowance that, in management's evaluation, is adequate to provide coverage for inherent losses on outstanding loans and leases. The allowance is calculated after considering credit quality factors, and ultimately relies on an overall internal analysis of risk in the loan portfolio. Based on this analysis, the provision is determined and recorded. The provision reflects results of an allowance methodology that is driven by risk ratings, historical losses, specific loan loss allocations, and qualitative factors. The 2018 provision reflected a number of factors, including loan growth, and other quantitative and qualitative considerations. Key indicators of loan quality remained consistent with prior years. Bancorp considers present asset quality metrics to be strong. Recognizing the cyclical nature of the lending business, this trend will most likely normalize over the long term. More information on this process can be found in the "allowance for loan and lease losses" section.

Non-performing loans decreased to \$3.4 million at December 31, 2018 from \$7.4 million at year-end 2017, consistent with the decline in non-accrual loans. Troubled debt restructurings (TDRs) currently accruing interest, decreased from \$869 thousand at December 31, 2017 to \$42 thousand at December 31, 2018, declining as a result of payoffs in full of two loans and scheduled payments applied to principal on two remaining loans. The ratio of non-performing loans to total loans was 0.13% at December 31, 2018, compared with 0.31% at December 31, 2017 with both ratios representing historic lows. Another key metric, net charge-offs, totaled 0.08% of average loans for 2018, as compared with 0.07% reported for 2017. See "Financial Condition-Non-performing Loans and Assets" for further discussion of non-performing loans. See "Financial Condition-Summary of Loan and Lease Loss Experience" for further discussion of loans charged off during the year.

Bancorp's loan portfolio is diversified with no significant concentrations of credit. Geographically, most loans are extended to borrowers in the metropolitan areas of Louisville, Indianapolis and Cincinnati. The adequacy of the allowance is monitored on an ongoing basis and it is the opinion of management that the balance of the allowance at December 31, 2018 is adequate to absorb probable losses inherent in the loan portfolio as of the financial statement date. See "Financial Condition - Allowance for loan and lease losses" for more information on the allowance.

Table of Contents**Non-Interest Income**

The following table provides a comparison of components of non-interest income for years ended 2018, 2017 and 2016. Below the table is a discussion of significant changes and trends.

| (Dollars in thousands) | 2018 | 2017 | 2016 | 2018/2017 | | 2017/2016 | | | |
|---|----------|----------|----------|-----------|---------|-----------|---------|--|--|
| | | | | Change | | Change | | | |
| | | | | \$ | % | \$ | % | | |
| Wealth management and trust services | \$21,536 | \$20,505 | \$19,155 | \$1,031 | 5.0 % | \$1,350 | 7.0 % | | |
| Deposit service charges | 5,759 | 6,172 | 6,037 | (413) | (6.7) | 135 | 2.2 | | |
| Debit and credit cards | 6,769 | 5,979 | 5,655 | 790 | 13.2 | 324 | 5.7 | | |
| Treasury management | 4,571 | 4,297 | 3,867 | 274 | 6.4 | 430 | 11.1 | | |
| Mortgage banking | 2,568 | 3,221 | 3,897 | (653) | (20.3) | (676) | (17.3) | | |
| Loss on sale of securities | — | (232) | — | 232 | 100.0 | (232) | (100.0) | | |
| Net investment product sales commissions and fees | 1,677 | 1,629 | 1,563 | 48 | 2.9 | 66 | 4.2 | | |
| Bank owned life insurance | 1,129 | 1,159 | 871 | (30) | (2.6) | 288 | 33.1 | | |
| Other | 1,337 | 1,769 | 1,875 | (432) | (24.4) | (106) | (5.7) | | |
| | \$45,346 | \$44,499 | \$42,920 | \$847 | 1.9 % | \$1,579 | 3.7 % | | |

Wealth Management and Trust

The largest component of non-interest income is WM&T revenue. The magnitude of WM&T revenue distinguishes Bancorp from other community banks of similar asset size. Trust assets under management totaled \$2.8 billion at December 31, 2018, unchanged from the \$2.8 billion at December 31, 2017. Assets under management are stated at market value. WM&T revenue, which constitutes an average of 47% of non-interest income, increased \$1.0 million, or 5.0%, for 2018 compared with 2017. The 2018 increase in WM&T revenue was the result of both a rising stock market for much of the year and continued addition of new clients added. Recurring fees, which generally comprise over 97% of the WM&T revenue, increased \$789 thousand, or 3.9%, in 2018, compared with 2017. Recurring fees earned for managing accounts are based on a percentage of market value of the assets under management and are typically assessed on a monthly basis. Some revenues of the WM&T department, most notably executor, insurance, and some employee benefit plan-related fees, are non-recurring in nature and the timing of these revenues corresponds with the related administrative activities, and is also based on the market value of assets under management. Total non-recurring fees increased \$242 thousand for 2018, compared with 2017 due to an increase in estate fees. Contracts between WM&T and their clients do not permit performance based fees and accordingly, none of the fees earned by WM&T are performance based. Management believes the WM&T department will continue to factor significantly in Bancorp's financial results and provide strategic diversity to revenue streams. Management is optimistic that the WM&T department will deliver consistent growth in 2019, but notes that increased market volatility could affect

near-term results.

The following table provides information regarding assets under management by WM&T as of December 31, 2018 and 2017. This table highlights that:

Approximately 80% of AUM is actively managed.

Corporate retirement plan accounts consist primarily of participant directed assets.

The amount of custody and safekeeping accounts is insignificant, and

The majority of managed assets are in personal trust and investment advisory accounts.

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| Assets Under Management by Account Type (In thousands) | As of December 31, 2018 | | As of December 31, 2017 | |
|---|----------------------------|--------------------|----------------------------|--------------------|
| | Managed | Non-managed (1) | Managed | Non-managed (1) |
| Personal trust accounts | \$532,254 | \$ 80,167 | \$535,931 | \$ 98,358 |
| Personal individual retirement accounts | 344,900 | 2,363 | 350,841 | 7,407 |
| Corporate retirement accounts | 47,884 | 390,619 | 54,688 | 400,793 |
| Investment advisory accounts | 1,077,904 | 34,214 | 1,079,569 | 21,213 |
| Foundation and endowment accounts | 187,492 | 1,020 | 208,314 | – |
| Total accounts | \$2,190,434 | \$ 508,383 | \$2,229,343 | \$ 527,771 |
| Custody and safekeeping accounts | – | 66,058 | – | 52,385 |
| Totals | \$2,190,434 | \$ 574,441 | \$2,229,343 | \$ 580,156 |
| Total managed and non-managed assets | \$2,764,875 | | \$2,809,499 | |

(1) Non-managed assets represent those for which WM&T does not have investment discretion.

The table below presents data regarding WM&T managed assets by class of investment as of December 31, 2018 and 2017. Managed assets are invested in instruments for which market values can be readily determined, the majority of which are sensitive to market fluctuations. This table demonstrates that:

The composition of managed assets is divided approximately 60% in equities and 40% in fixed income, and this composition is relatively consistent from year to year, and
The Bank has no proprietary mutual funds.

Managed Assets by Class of Investment

| (In thousands) | As of December 31, | |
|---|--------------------|---------|
| | 2018 | 2017 |
| Non-interest bearing deposits | \$– | \$– |
| Interest bearing deposits | 139,779 | 127,237 |
| US Treasury and government agency obligations | 53,513 | 43,582 |
| State, county and municipal obligations | 128,057 | 135,056 |
| Money market mutual funds | 8,627 | 7,811 |
| Equity mutual funds | 485,961 | 560,605 |
| Other mutual funds - fixed, balanced, and municipal | 290,352 | 304,765 |
| Other notes and bonds | 155,701 | 124,380 |
| Common and preferred stocks | 801,690 | 843,006 |
| Real estate mortgages | 352 | 369 |
| Real estate | 49,840 | 49,344 |
| Other miscellaneous assets (1) | 76,562 | 33,188 |

Total managed assets \$2,190,434 \$2,229,343

(1) Includes client directed instruments including rights, warrants, annuities, insurance policies, unit investment trusts, and oil and gas rights.

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The table below provides information regarding fee income earned by Bancorp's WM&T department for the years ended December 31, 2018, 2017 and 2016. It demonstrates that WM&T fee revenue is earned most significantly from personal trust and investment advisory accounts. Fees are based on AUM and tailored for individual accounts and/or relationships. WM&T uses a fee structure that considers and tailors based on type of account and other factors. For example, fee structures are in place for investment management, irrevocable trusts, revocable trusts, IRA accounts, and accounts holding only fixed income securities. There are also fee structures for estate settlements, which are non-recurring, and retirement plan services which can include a one-time conversion fee with recurring AUM fees to follow. All fees are based on market value of each account and are tiered based on account size, with larger relationships paying a lower percentage of AUM in fees. Fees are agreed upon at the time an account is opened and these and any subsequent revisions are communicated in writing to the customer. Fees earned are not performance based nor are they based on investment strategy or transactions.

Wealth Management and Trust Services Income

| (In thousands) | Years Ended December 31, | | |
|---|--------------------------|----------|----------|
| | 2018 | 2017 | 2016 |
| Personal trust accounts | \$7,322 | \$7,285 | \$7,142 |
| Personal individual retirement accounts | 4,994 | 4,829 | 4,649 |
| Investment advisory accounts | 8,395 | 7,464 | 6,521 |
| Foundation and endowment accounts | 552 | 540 | 491 |
| Custody and safekeeping accounts | 161 | 152 | 104 |
| Brokerage and insurance services | 53 | 40 | 45 |
| Other | 59 | 195 | 203 |
| Total | \$21,536 | \$20,505 | \$19,155 |

Additional sources of non-interest income

Deposit service charges decreased \$413 thousand, or 6.7%, for 2018 compared with 2017. Service charge income is driven by transaction volume, which can fluctuate throughout the year. The decreases for 2018 are primarily due to customers transitioning away from fee based accounts towards fee free checking offerings and a reduction in fees related to overdrawn checking accounts. Management expects this source of revenue to slowly decline due to anticipated changes in customer behavior, including reduced check volume, and ongoing regulatory restrictions.

Deposit service charges increased \$135 thousand, or 2.2%, for 2017 compared with 2016. The increase for 2017 was primarily due to the introduction of a new checking account in the third quarter of 2016. This product provides ancillary services to customers, while carrying a monthly service charge. Fees earned on this product in 2017 totaled \$846 thousand compared with \$440 thousand in 2016. Another significant component of service charges is related to

fees earned on checking account overdrafts, which declined \$145 thousand in 2018 compared with 2017.

Debit and credit card revenue increased \$790 thousand, or 13.2%, for 2018 compared with 2017. This revenue stream is impacted by both growth in the customer base and corresponding debit and credit card usage. Debit card interchange income increased \$386 thousand or 7.9% in 2018, as compared with 2017. Looking forward to 2019, Bancorp expects a slight decrease in interchange rates as service providers gravitate to lower cost options within the market, however, growth in number of accounts and transaction volume is anticipated to offset the decline in rates. Commercial credit card income increased \$376 thousand, or 33.9%, year over year. Volume, which is dependent upon customer behavior and new accounts, is expected to continue to increase in 2019. In contrast, interchange income is based on rates set by service providers in a competitive market.

Debit and credit card revenue increased \$324 thousand or 5.7% in 2017 compared with 2016 due largely to increased volume resulting from newly offered commercial credit cards, offset by decreased debit card revenue.

Treasury management revenue primarily consists of fees earned for cash management services provided to commercial customers. This category has been a growing source of revenue for Bancorp including an increase in 2018 of \$274 thousand or 6.4% compared with 2017. Treasury management revenue increased \$430 thousand or 11.1% in 2017 compared with 2016. Bancorp expects this category to continue to grow in 2019 at a pace comparable to 2018 due to an expanding customer base and as more existing customers take advantage of offered services.

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Mortgage banking revenue primarily includes gains on sales of mortgage loans. Bancorp's originates residential mortgage loans to be sold in the secondary market. Interest rates on loans sold are locked with the investor prior to closing the loans, thus Bancorp bears no interest rate risk related to these loans. The Company offers conventional, Veterans Affairs and Federal Housing Administration financing, for purchases and refinances, as well as programs for first-time home buyers. Interest rates on mortgage loans directly impact the volume of business transacted by the mortgage banking division. Mortgage banking revenue decreased \$653 thousand, or 20.3%, in 2018 compared with 2017 after having decreased \$676 thousand or 17.3% in 2017 compared with 2016. As interest rates have risen, Bancorp has experienced a slowing of refinancing activity. In Bancorp's primary market of Louisville, Kentucky, the housing inventory was generally low throughout 2018, also contributing to the declines.

In 2018 and 2016, Bancorp did not sell any securities available for sale. In 2017, Bancorp sold an equity security realizing a loss of \$263 thousand. One security was called prior to maturity in 2017 resulting in the receipt of a \$31 thousand pre-payment penalty. Management has the intent and ability to hold all remaining investment securities available for sale for the foreseeable future.

Net investment product sales commissions and fees increased \$48 thousand, or 2.9% in 2018, corresponding to overall brokerage volume. Net investment product sales commissions increased \$66 thousand or 4.2% in 2017 despite Department of Labor regulations that resulted in fee restructuring, and in many cases reductions, for many types of investment products. Investment products commissions and fees consist primarily of stock, bond, and mutual fund sales, as well as wrap fees on accounts. Wrap fees are charges for investment programs that bundle together a suite of services, such as brokerage, advisory, research and management, and are based on a percentage of assets. Bancorp deploys its brokers primarily through its branch network via an arrangement with a third party broker-dealer, while larger managed accounts are serviced in the Bank's WM&T department.

Bank owned life insurance ("BOLI") assets represent the cash surrender value of life insurance policies on certain key employees who have provided consent for Bancorp to be the beneficiary of a portion of such policies. The related change in cash surrender value and any death benefits received under the policies are recorded as non-interest income. This income helps offset costs of various employee benefits. Income related to BOLI decreased \$30 thousand, or 2.6% in 2018. The decrease is attributable to decreasing crediting rates on investments. BOLI income in 2018 included life insurance proceeds of \$382 thousand. BOLI income increased \$288 thousand or 33.1% in 2017 compared with 2016 as a result of life insurance proceeds of \$348 thousand.

Other non-interest income decreased \$432 thousand, or 24.4%, during 2018 compared with 2017. Included in this category is interest rate swap fee income, which totaled \$119 thousand and \$227 thousand for 2018 and 2017, respectively. Opportunities to earn swap fee income are sporadic due to the specialized nature of these type of transactions. Other non-interest income decreased \$106 thousand or 5.7% during 2017 compared with 2016. Swap fees in 2017 declined \$300 thousand compared with 2016 while income related to exiting tax credit partnerships increased \$154 thousand in 2017 compared with 2016. This category contains a variety of other income sources, none of which resulted in individually significant variances in either comparison.

Table of Contents**Non-interest expenses**

The following table provides a comparison of components of non-interest expenses for years ended 2018, 2017 and 2016. Below the table is a discussion of significant changes and trends.

| (Dollars in thousands) | 2018 | 2017 | 2016 | 2018/2017 | | 2017/2016 | |
|---|----------|----------|----------|-----------|---------|-----------|--------|
| | | | | Change | | Change | |
| | \$ | | | \$ | % | \$ | % |
| Compensation | \$46,104 | \$42,581 | \$40,814 | \$3,523 | 8.3 % | \$1,767 | 4.3 % |
| Employee benefits | 10,098 | 9,987 | 8,368 | 111 | 1.1 | 1,619 | 19.3 |
| Net occupancy and Equipment | 7,653 | 7,393 | 7,422 | 260 | 3.5 | (29) | (0.4) |
| Technology and Communications | 8,897 | 7,957 | 7,040 | 940 | 11.8 | 917 | 13.0 |
| Marketing and business Development | 3,099 | 2,716 | 2,464 | 383 | 14.1 | 252 | 10.2 |
| Postage, printing and Supplies | 1,558 | 1,475 | 1,521 | 83 | 5.6 | (46) | (3.0) |
| Legal and professional | 2,614 | 2,393 | 1,869 | 221 | 9.2 | 524 | 28.0 |
| FDIC insurance | 961 | 960 | 1,181 | 1 | 0.1 | (221) | (18.7) |
| Amortization/impairment of investments in tax credit partnerships | 1,237 | 7,124 | 4,458 | (5,887) | (82.6) | 2,666 | 59.8 |
| Capital and deposits based taxes | 3,325 | 3,440 | 2,800 | (115) | (3.3) | 640 | 22.9 |
| Other | 3,963 | 4,394 | 3,001 | (431) | (9.8) | 1,393 | 46.4 |
| | \$89,509 | \$90,420 | \$80,938 | \$(911) | (1.0)% | \$9,482 | 11.7 % |

Compensation, which includes salaries, incentives, bonuses, and stock based compensation, increased \$3.5 million or 8.3% in 2018 compared with 2017, and \$1.8 million or 4.3% in 2017, as compared with 2016. The increases reflected higher salaries, increased production and performance based compensation, including stock compensation, and the addition of personnel associated with growth and operational support. At December 31, 2018, Bancorp had 591 full-time equivalent employees compared with 580 at December 31, 2017 and 578 at December 31, 2016.

Employee benefits consists of all personnel related expense not included in compensation, with the two most significant items being health insurance and payroll taxes. Employee benefits increased \$111 thousand or 1.1% in 2018 compared with 2017, primarily due to increased health insurance costs year over year. Bancorp is self-insured, and health insurance costs fluctuate based on levels of claims. The increase in employee benefits in 2017 compared with 2016 was due primarily to increased health insurance costs year over year of \$1.4 million.

Net occupancy and equipment expense increased \$260 thousand, or 3.5%, from 2018 to 2017. This category primarily includes rent, depreciation, and maintenance, variances for which were not individually significant. In 2017 this category expense decreased \$29 thousand or 0.4% compared with 2016. At December 31, 2018, Bancorp had 38

banking center locations, including the main office, and a separate operations center. Costs of capital asset additions flow through the statement of income over lives of the assets in the form of depreciation expense.

Technology and communications expenses increased \$940 thousand, or 11.8%, from 2017 to 2018, and \$917 thousand or 13.0% in 2017, as compared with 2016 largely due to increases in computer operations additions and improvements. This category includes computer software amortization, equipment depreciation, and expenditures related to investments in new technology needed to maintain and improve the quality of customer delivery channels, information security, and internal resources.

Marketing and business development expenses include all costs associated with promoting Bancorp, community investment, retaining customers and acquiring new business. Category expense increased \$383 thousand or 14.1% in 2018 compared with 2017, due largely to advertising costs associated with deposit gathering campaigns in the second and third quarters of 2018. Expense in 2017 compared with 2016 increased \$252 thousand or 10.2% due largely to an increase in community donations within Bancorp's market areas offset somewhat by decreased advertising expense.

Postage, printing and supplies expenses increased \$83 thousand or 5.6% in 2018 compared with 2017. The increase year over year was comprised of numerous items, none of which were individually significant. Expense in 2017 decreased \$46 thousand or 3.0% compared with 2016. The decline year over year was comprised of numerous items, none of which were individually significant.

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Legal and professional fees increased \$221 thousand to \$2.6 million in 2018 from \$2.4 million in 2017 due to costs associated with Bancorp's pending acquisition. Legal and professional fees increased \$524 thousand in 2017 compared with 2016. Legal fees increased \$174 thousand or 34% in 2017 compared with 2016 primarily due to increased litigation costs arising through the normal course of business. Professional and consulting fees increased \$350 thousand or 26.5% due to increased fees associated with out-sourcing assistance for loan review and tax services.

FDIC insurance expense was unchanged in 2018, as compared with 2017. During 2016, the FDIC revised the assessment criteria to more closely align FDIC assessments with each financial institution's risks. Bancorp benefited from this change which resulted in 2017 expense decreasing \$221 thousand or 18.7% compared with 2016.

Capital and deposit based taxes decreased \$115 thousand or 3.3% in 2018, as compared with 2017 as a result of reduced local deposit-based tax expense. In 2017 capital and deposit based taxes increased \$640 thousand, or 22.9% due to increased capital-based franchise tax.

Amortization/impairment of investments in tax credit partnership decreased \$5.9 million for the year ended December 31, 2018 compared with the same period of 2017. The 2017 expense represented a \$2.7 million increase compared with 2016. These partnerships generate federal income tax credits. For each of Bancorp's investments in tax credit partnerships, the tax benefit compared to related expenses results in a positive effect on net income. The amounts of credits and corresponding expenses can vary widely depending upon the timing and magnitude of investments. See the Income Taxes section below for details on these credits and expenses.

Other non-interest expenses decreased \$431 thousand, or 9.8% for the year ended December 31, 2018 compared with the same period of 2017. Expenses for 2017 included a \$266 thousand liability accrual related to an estimated loss from certain administrative proceedings arising in the course of business.

Other non-interest expenses increased \$1.4 million, or 46.4% for the year ended December 31, 2017 compared with the same period of 2016. Significant items impacting the variance consisting of the following:

A recovery of \$588 thousand in 2016 related to an impairment loss recognized in 2008.

A decrease of \$370 thousand on gains from the sale of repossessed assets, as 2017 net gains totaled \$39 thousand compared with \$409 thousand in 2016.

A \$266 thousand liability accrual in 2017 related to an estimated loss from certain administrative proceedings arising in the course of our business.

Expenses associated with a checking account product increased \$137 thousand in 2017 over 2016.

Fraud related losses increased \$165 thousand in 2017 compared with 2016.

Bancorp's efficiency ratio for 2018 of 55.92% decreased from 60.61% in 2017. Excluding amortization of investments in tax credit partnerships, the adjusted efficiency ratio, a non-GAAP measure, would have been 55.15% and 55.84% for 2018 and 2017, respectively. See the Non-GAAP Financial Measures section for details on reconciliation to US GAAP measures.

Income Taxes

A three year comparison of income tax expense and effective tax rate follows:

| (Dollars in thousands) | 2018 | 2017 | 2016 |
|------------------------|-------------|-------------|-------------|
| Income tax expense | \$12,031 | \$17,139 | \$15,244 |
| Effective tax rate | 17.81 % | 31.06 % | 27.1 % |

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The decrease in the effective tax rate from 2017 to 2018 was due to the decrease in the federal marginal income tax rate from 35% to 21% effective January 1, 2018, as a result of the Tax Cuts and Jobs Act enacted on December 22, 2017. The 2017 effective tax rate was significantly increased by a \$5.9 million charge, also due to the Tax Cuts and Jobs Act, to revalue Bancorp's net deferred tax asset. The increase was somewhat offset by the positive effects of federal income tax credits and stock-based compensation. Bancorp invests in certain partnerships that yield federal income tax credits. Taken as a whole, the tax benefit of these investments exceeds amortization/impairment expense associated with them, resulting in a positive impact on net income. The timing and magnitude of these transactions may vary widely.

The increase in the effective tax rate, 2016 to 2017, was primarily the result of a non-cash charge of \$5.9 million resulting from tax reform offset partially by higher utilization of federal income tax credits in 2017. Bancorp invests in certain partnerships that yield federal income tax credits. For each of Bancorp's investments in tax credit partnerships the tax benefit compared to related expenses results in a positive effect on net income. Also partially offsetting the effect of the tax reform related charge was the adoption of ASU 2016-09 "Compensation – Stock Compensation Improvements to Employee Share-Based Payment Accounting." The standard requires excess tax benefits and deficiencies related to share-based payment awards to be reflected in the statement of operations as a component of the provision for income taxes. For 2017 Bancorp recorded a benefit of \$1.5 million for such excess benefits against the provision for income tax expense. Prior to adoption of ASU 2016-09, these tax benefits were recorded directly to additional paid-in capital. Tax benefits recorded to capital for 2016 was \$1.7 million.

Financial Condition**Earning Assets and Interest Bearing Liabilities**

Summary information with regard to Bancorp's financial condition follows:

| (Dollars in thousands) | 2018 | 2017 | 2016 | 2018/2017 | | 2017/2016 | |
|--------------------------------------|-------------|-------------|-------------|-----------|------|-----------|------|
| | | | | Change | % | Change | % |
| Average earning assets | \$2,998,526 | \$2,872,717 | \$2,730,949 | \$125,809 | 4.4% | \$141,768 | 5.2% |
| Average interest bearing liabilities | 2,063,709 | 1,980,873 | 1,895,258 | 82,836 | 4.2 | 85,615 | 4.5 |
| Average total assets | 3,159,726 | 3,037,581 | 2,886,396 | 122,145 | 4.0 | 151,185 | 5.2 |
| Total year end assets | 3,302,924 | 3,239,646 | 3,039,481 | 63,278 | 2.0 | 200,165 | 6.6 |

Bancorp continues to experience growth in earning assets primarily in the area of loans. From 2017 to 2018, average loans increased 9.4%, or \$214.4 million, compared with 6.7% or \$143.3 million from 2016 to 2017. Growth has been all organic and each of Bancorp's three markets participated in accelerated loan production and net loan growth. Bancorp was able to achieve 5.8% annual loan growth in 2018 despite elevated levels of commercial real estate (CRE) and commercial and industrial loan payoffs, resulting from borrowers moving elsewhere for permanent financing and CRE loans for which collateral was sold. These repayments were largely anticipated. Loan growth during 2018 reflected ongoing expansion in key lending categories such as commercial and industrial lending and owner-owner occupied commercial real estate lending. Bancorp has remained well under regulatory guidelines for commercial investment real estate. Utilization rates on lines of credit excluding construction loans were 51%, 52% and 51% as of December 31 2018, 2017 and 2016, respectively. Somewhat offsetting loan growth, average securities available-for-sale decreased \$43.9 million, or 9.6% from 2017 to 2018, compared with decreasing \$21.0 million, or 4.4% from 2016 to 2017. Average federal funds sold and interest bearing due from banks likewise decreased 40.7% or \$46.0 million in 2018, as excess cash balances were used to fund loan growth. In 2017 federal funds sold increased \$20.1 million or 21.6%, as compared with 2016.

The increase in average interest bearing liabilities from 2017 to 2018 occurred primarily in demand deposits, time deposits, and federal funds purchased and other short-term borrowings. Average total interest bearing deposit accounts increased 3.6% and average non-interest bearing deposit accounts increased 2.8% in 2018. Average time deposits increased 17.5% or \$41.5 million in 2018, as compared with decreasing 5.9% or \$14.8 million in 2017. Bancorp was successful in increasing time deposits in 2018 in all markets, particularly in the Louisville market, through an aggressive deposit gathering campaign. The Company also purchased \$30 million of brokered deposits in 2018, after having no brokered deposits in 2017. Bancorp continued to utilize fixed rate advances from the FHLB during 2018 as these rates compared favorably to similar term time deposits. Bancorp had an average of \$48.8 million in outstanding FHLB advances in 2018 compared with \$50.3 million in 2017. Securities sold under agreement to repurchase averaged \$62.6 million in 2018 compared with \$70.2 million in 2017. Securities sold under agreements to repurchase represent excess funds from certain commercial customers as part of a cash management service.

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At December 31, 2018, Bancorp had excess cash balances resulting from seasonal deposits of approximately \$88 million. These funds are invested in short-term investments, as deposit balances are expected to return to normal levels during the first two quarters of 2019. While these accounts are profitable, the excess investment is expected to have a negative effect on net interest margin for the first six months of 2019 since short term rates are significantly lower than rates for longer term earning assets.

Average Balances and Interest Rates – Taxable Equivalent Basis

| (Dollars in thousands) | Year 2018 | | | Year 2017 | | | Year 2016 | | |
|--|------------------|----------|--------------|------------------|----------|--------------|------------------|----------|--------------|
| | Average balances | Interest | Average rate | Average balances | Interest | Average rate | Average balances | Interest | Average rate |
| Earning assets: | | | | | | | | | |
| Federal funds sold and interest bearing due from banks | \$67,083 | \$1,307 | 1.95 % | \$113,088 | \$1,330 | 1.18 % | \$92,994 | \$491 | 0.53 % |
| Mortgage loans held for sale | 2,549 | 166 | 6.51 | 3,545 | 191 | 5.39 | 4,881 | 237 | 4.86 |
| Securities | | | | | | | | | |
| Taxable | 377,126 | 8,492 | 2.25 | 406,342 | 8,030 | 1.98 | 419,422 | 8,197 | 1.95 |
| Tax-exempt FHLB stock and other securities | 37,943 | 1,006 | 2.65 | 52,614 | 1,558 | 2.96 | 60,516 | 1,710 | 2.83 |
| Loans, net of unearned income | 2,504,477 | 118,600 | 4.74 | 2,290,112 | 100,248 | 4.38 | 2,146,789 | 92,152 | 4.29 |
| Total earning assets | 2,998,526 | 130,080 | 4.34 % | 2,872,717 | 111,692 | 3.89 % | 2,730,949 | 103,041 | 3.77 % |
| Less allowance | 25,130 | | | 24,974 | | | 23,454 | | |
| | 2,973,396 | | | 2,847,743 | | | 2,707,495 | | |
| Non interest earning assets: | | | | | | | | | |
| Cash and due from banks | 42,783 | | | 41,621 | | | 41,043 | | |
| Premises and equipment | 42,773 | | | 41,793 | | | 41,813 | | |

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| | | | | | | | | | |
|---|-------------|---------|--------|-------------|---------|--------|-------------|-------|--------|
| All other assets | 100,774 | | | 106,424 | | | 96,045 | | |
| Total assets | \$3,159,726 | | | \$3,037,581 | | | \$2,886,396 | | |
| Interest bearing liabilities: | | | | | | | | | |
| Deposits | | | | | | | | | |
| Interest bearing demand deposits | | | | | | | | | |
| | \$811,748 | \$4,008 | 0.49 % | \$757,023 | \$1,574 | 0.21 % | \$717,800 | \$978 | 0.14 % |
| Savings deposits | | | | | | | | | |
| | 156,212 | 311 | 0.20 | 148,510 | 179 | 0.12 | 135,051 | 47 | 0.03 |
| Money market deposits | | | | | | | | | |
| | 660,222 | 5,529 | 0.84 | 697,182 | 2,740 | 0.39 | 658,837 | 1,477 | 0.22 |
| Time deposits | | | | | | | | | |
| | 278,888 | 3,593 | 1.29 | 237,368 | 1,482 | 0.62 | 252,170 | 1,441 | 0.57 |
| Securities sold under agreements to repurchase | | | | | | | | | |
| | 62,580 | 157 | 0.25 | 70,187 | 134 | 0.19 | 62,670 | 136 | 0.22 |
| Federal funds purchased and other short-term borrowings | | | | | | | | | |
| | 45,293 | 835 | 1.84 | 20,303 | 182 | 0.90 | 23,275 | 76 | 0.33 |
| FHLB advances | | | | | | | | | |
| | 48,766 | 924 | 1.89 | 50,300 | 955 | 1.90 | 45,455 | 763 | 1.68 |
| Total interest bearing liabilities | | | | | | | | | |
| | 2,063,709 | 15,357 | 0.74 % | 1,980,873 | 7,246 | 0.37 % | 1,895,258 | 4,918 | 0.26 % |
| Non-interest bearing liabilities | | | | | | | | | |
| Non-interest bearing demand deposits | | | | | | | | | |
| | 703,453 | | | 684,044 | | | 650,036 | | |
| Accrued interest payable and other liabilities | | | | | | | | | |
| | 45,523 | | | 44,866 | | | 36,951 | | |
| Total liabilities | | | | | | | | | |
| | 2,812,685 | | | 2,709,783 | | | 2,582,245 | | |
| Stockholders' equity | | | | | | | | | |
| | 347,041 | | | 327,798 | | | 304,151 | | |
| Total liabilities and | | | | | | | | | |
| | \$3,159,726 | | | \$3,037,581 | | | \$2,886,396 | | |

stockholders'
equity

| | | | |
|---------------------|------------|------------|-----------|
| Net interest income | \$ 114,723 | \$ 104,446 | \$ 98,123 |
| Net interest spread | 3.60 % | 3.52 % | 3.51 % |
| Net interest margin | 3.83 % | 3.64 % | 3.59 % |

Notes:

Yields on municipal securities have been computed on a fully tax-equivalent basis using a federal income tax rate of 21% in 2018, and 35% in 2017 and 2016.

The approximate tax-equivalent adjustments to interest income were \$307,000, \$793,000 and \$834,000 for the years ended December 31, 2018, 2017 and 2016, respectively.

Average balances for loans include the principal balance of non-accrual loans and exclude participation loans accounted for as secured borrowings. The average balance of these participation loans totaled \$15,459,000, \$18,744,000 and \$12,364,000 for the years ended December 31, 2018, 2017 and 2016.

Loan interest income includes loan fees and is computed on a fully tax-equivalent basis using the federal income tax rate of 21% for 2018, and 35% for 2017 and 2016. Loan fees, net of deferred costs, included in interest income amounted to \$1,300,000, \$1,063,000 and \$1,402,000 in 2018, 2017 and 2016, respectively.

Table of Contents**Securities**

The primary purpose of the securities portfolio is to provide another source of interest income, as well as liquidity management. In managing the composition of the balance sheet, Bancorp seeks a balance between earnings sources and credit and liquidity considerations.

Securities available for sale include securities that may be sold in response to changes in interest rates, resultant prepayment risk and other factors related to interest rate and prepayment risk changes. Securities available for sale are carried at fair value with unrealized gains or losses, net of tax effect, included in stockholders' equity.

All of Bancorp's securities are available for sale. Carrying value is summarized as follows:

| (In thousands) | As of December 31, | |
|--|---------------------------|-------------|
| | 2018 | 2017 |
| U.S. Treasury obligations | \$– | \$149,984 |
| Government sponsored enterprise obligations | 261,039 | 213,844 |
| Mortgage-backed securities – government agencies | 146,277 | 161,507 |
| Obligations of states and political subdivisions | 29,679 | 49,189 |
| | \$436,995 | \$574,524 |

At December 31, 2017 securities available for sale included \$150 million of short-term U.S. Treasury obligation purchased in conjunction with a tax savings strategy. At December 31, 2018, Bancorp did not make a similar purchase.

Maturity distribution and weighted average interest rates of debt securities available for sale at December 31, 2018 are as follows:

| (Dollars in thousands) | Within one year | | After one but within five years | | After five but within ten years | | After ten years | |
|---|------------------------|-------------|--|-------------|--|-------------|------------------------|-------------|
| | Amount | Rate | Amount | Rate | Amount | Rate | Amount | Rate |
| Government sponsored enterprise obligations | \$110,426 | 2.06% | \$47,822 | 1.75% | \$3,471 | 2.08% | \$99,320 | 2.71% |

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| | | | | | | | | |
|---|-----------|-------|----------|-------|----------|-------|-----------|-------|
| Mortgage-backed securities – government agencies | 4,555 | 2.01 | 5,775 | 2.39 | 36,826 | 2.04 | 99,121 | 2.49 |
| Obligations of states and political subdivisions | 9,813 | 2.16 | 15,438 | 2.11 | 4,428 | 1.80 | – | – |
| | \$124,794 | 2.07% | \$69,035 | 1.88% | \$44,725 | 2.02% | \$198,441 | 2.60% |

Actual maturities for mortgage-backed securities may differ from contractual maturities due to prepayments on underlying collateral.

Table of Contents**Loan Portfolio**

Bancorp's primary source of income is interest on loans. Composition of loans as of December 31 for each of the last five years follows:

| (In thousands) | 2018 | 2017 | 2016 | 2015 | 2014 |
|--|-------------|-------------|-------------|-------------|-------------|
| Commercial and industrial | \$ 833,524 | \$ 779,014 | \$ 736,841 | \$ 644,398 | \$ 571,754 |
| Construction and development, excluding undeveloped land | 225,050 | 195,912 | 192,348 | 134,482 | 95,733 |
| Undeveloped land (1) | 30,092 | 18,988 | 21,496 | 21,185 | 21,268 |
| Real estate mortgage: | | | | | |
| Commercial investment | 588,610 | 594,902 | 538,886 | 436,989 | 448,567 |
| Owner Occupied commercial | 426,373 | 398,685 | 408,292 | 420,666 | 380,237 |
| 1-4 family residential | 276,017 | 262,110 | 249,498 | 226,575 | 211,548 |
| Home equity - first lien | 49,500 | 57,110 | 55,325 | 50,115 | 43,779 |
| Home equity - junior lien | 70,947 | 63,981 | 67,519 | 63,066 | 66,268 |
| Subtotal: Real estate mortgage | 1,411,447 | 1,376,788 | 1,319,520 | 1,197,411 | 1,150,399 |
| Consumer | 48,058 | 38,868 | 35,170 | 35,531 | 29,396 |
| Total loans | \$2,548,171 | \$2,409,570 | \$2,305,375 | \$2,033,007 | \$1,868,550 |

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

Bancorp's loan portfolio increased \$139 million, or 5.8%, during 2018 as a result of record loan production and stable utilization of available lines of credit while being challenged by elevated levels of prepayments and payoffs.

Bancorp occasionally enters into loan participation agreements with other banks to diversify credit risk. For certain sold participation loans, Bancorp has retained effective control of the loans, typically by restricting the participating institutions from pledging or selling their share of the loan without permission from Bancorp. US GAAP requires the participated portion of these loans to be recorded as secured borrowings. These participated loans are included in commercial and industrial and real estate mortgage loan totals above, and a corresponding liability is recorded in other liabilities. At December 31, 2018 and 2017, total participated portions of loans of this nature were \$10.5 million and \$18.2 million respectively.

The following tables detail amounts of loans at December 31, 2018 which, based on remaining scheduled repayments of principal, are due in the periods indicated. Also shown are commercial and industrial loans due after one year and

construction, development and undeveloped land loans due after one year, classified according to sensitivity to changes in interest rates.

| (In thousands) | Maturing | | | |
|---|------------------|--------------------|------------------|--------------------|
| | Within | After one | After | Total |
| | one | but | five | |
| | year | within five | years | |
| | | years | | |
| Commercial and industrial | \$332,150 | \$362,745 | \$138,629 | \$833,524 |
| Construction and development including undeveloped land | 74,709 | 105,388 | 75,045 | 255,142 |
| Real estate mortgage | 151,369 | 711,505 | 548,573 | 1,411,447 |
| Consumer | 32,308 | 15,297 | 453 | 48,058 |
| Total loans | \$590,536 | \$1,194,935 | \$762,700 | \$2,548,171 |

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| Commercial and industrial loans due after one year (In thousands) | Interest sensitivity | |
|--|----------------------|---------------|
| | Fixed rate | Variable rate |
| Due after one but within five years | \$215,643 | \$147,102 |
| Due after five years | 62,635 | 75,994 |
| | \$278,278 | \$223,096 |

Construction and development

| including undeveloped land due after one year (In thousands) | Interest sensitivity | |
|---|----------------------|---------------|
| | Fixed rate | Variable rate |
| Due after one but within five years | \$31,630 | \$73,758 |
| Due after five years | 17,242 | 57,803 |
| | \$48,872 | \$131,561 |

To limit interest rate sensitivity on commercial and commercial real estate loans, whenever possible, Bancorp seeks to structure loans with maturity dates longer than five years with a rate adjustment occurring no longer than five years from origination date.

Non-performing Loans and Assets

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

| (Dollars in thousands) | December 31, | | | | |
|---|--------------|----------|----------|----------|----------|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Non-accrual loans (1) | \$2,611 | \$6,511 | \$5,295 | \$7,693 | \$5,199 |
| Troubled debt restructurings (TDRs) | 42 | 869 | 974 | 1,060 | 6,352 |
| Loans past due 90 days or more and still accruing | 745 | 2 | 438 | 176 | 329 |
| Non-performing loans | 3,398 | 7,382 | 6,707 | 8,929 | 11,880 |
| Other real estate owned | 1,018 | 2,640 | 5,033 | 4,541 | 5,977 |
| Non-performing assets | \$4,416 | \$10,022 | \$11,740 | \$13,470 | \$17,857 |
| Non-performing loans as a percentage of total loans | 0.13 % | 0.31 % | 0.29 % | 0.44 % | 0.64 % |
| Non-performing assets as a percentage of total assets | 0.13 % | 0.31 % | 0.39 % | 0.48 % | 0.70 % |

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| | | | | | | | | | | |
|--|-----|---|-----|---|-----|---|-------|---|-----|---|
| Allowance for loan loss as a percentage of non- performing loans | 751 | % | 337 | % | 358 | % | 251 | % | 210 | % |
| (1) Includes TDRs previously accruing of: | \$- | | \$- | | \$- | | \$400 | | \$- | |

Loans accounted for as TDRs included modifications from original terms such as those due to bankruptcy proceedings, certain changes to amortization periods or extended suspension of principal payments due to customer financial difficulties. To the extent that Bancorp chooses to work with borrowers by providing reasonable concessions rather than initiating collection, this would result in an increase in loans accounted for as TDRs. TDRs that are in non-accrual status are reported as non-accrual loans. Loans accounted for as TDRs are individually evaluated for impairment and are reported as non-performing loans. The table above includes information regarding loans reported as TDRs that moved from an accrual status to non-accrual during the periods reporting. (See (1) above)

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As of December 31, 2018, TDRs consisted of two loans totaling \$42 thousand. See note (5) to Bancorp's consolidated financial statements for additional information regarding loans classified as troubled debt restructurings.

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

| Non-accrual loans by type (In thousands) | December 31, | |
|--|--------------|---------|
| | 2018 | 2017 |
| Commercial and industrial | \$ 192 | \$ 321 |
| Construction and development, excluding undeveloped land | 318 | 664 |
| Undeveloped land | 474 | 474 |
| Real estate mortgage - commercial investment | 138 | 52 |
| Real estate mortgage - owner occupied commercial | 586 | 3,332 |
| Real estate mortgage - 1-4 family residential | 760 | 1,637 |
| Home equity | 143 | 31 |
| Consumer | — | — |
| Total | \$2,611 | \$6,511 |

Loans are placed in a non-accrual income status when prospects for recovering both principal and accrued interest are considered doubtful or when a default of principal or interest has existed for 90 days or more, unless such a loan is well secured and in the process of renewal. Interest income recorded on non-accrual loans was \$93 thousand, \$338 thousand, and \$307 thousand for 2018, 2017, and 2016, respectively. Interest income that would have been recorded if non-accrual loans were on a current basis in accordance with their original terms was \$391 thousand, \$159 thousand, and \$149 thousand for 2018, 2017, and 2016, respectively.

In addition to non-performing loans discussed above, there were loans, which are accruing interest, for which payments were current or less than 90 days past due where borrowers are experiencing elevated financial difficulties. These potential problem loans totaled approximately \$23.4 million, \$18.7 million, and \$9.3 million at December 31, 2018, 2017, and 2016, respectively. These relationships are monitored closely for possible future inclusion in non-performing loans. Management believes it has adequately reflected credit exposure in these loans in its determination of the allowance.

Non-performing assets as a percentage of total assets decreased 18 basis points from 2017 to 2018, reflecting improved credit quality and asset growth. At December 31, 2018 and 2017, the carrying value of other real estate owned ("OREO") was \$1.0 million and \$2.6 million, respectively. In 2018, Bancorp recorded impairment charges on such OREO totaling \$32 thousand, compared with \$171 thousand in 2017 and \$62 thousand in 2016.

Allowance for Loan and Lease Losses

An allowance has been established to provide for probable losses on loans that may not be fully repaid. The allowance is increased by provisions charged to expense and decreased by charge-offs, net of recoveries. Loans are typically charged off when management deems them uncollectible and after underlying collateral has been liquidated; however, collection efforts continue and future recoveries may occur. Periodically, loans are partially charged off to the net realizable value based upon evaluation of related underlying collateral, including Bancorp's proclivity for resolution.

Bancorp's lending policies and procedures center on mitigating credit risk and include procedures to identify and measure this risk. These procedures begin with lenders assigning a risk rating to each of their credits, and this rating is confirmed in the loan approval process for new and renewed loans. Internal loan review, through a year-round process of examining individually significant obligor relationships, concentrations, and a broad sample of Bancorp's portfolio, tests the reliability of these risk assessments. Additionally, a review of this process is an integral part of regulatory bank examinations.

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Adversely rated credits are included on a classified loan list which incorporates loans requiring closer monitoring due to borrower's circumstances. Loans are added to the classified loan list when circumstances are detected which might affect the borrower's ability to comply with terms of the loan. This could include any of the following:

- Delinquency of a scheduled loan payment,
- Deterioration in the borrower's or guarantor's financial condition identified in a review of periodic financial statements, which will impair repayment or collection,
- Decrease in value of collateral securing the loan, or
- Change in the economic environment in which the borrower operates.

Classified loans require detailed status reports, including recommended corrective actions, prepared periodically by the responsible loan officer. These reports are reviewed by management. Classified loans are also discussed quarterly with the Risk Committee of the Bank's Board of Directors.

Changes in loan risk ratings are typically initiated by the responsible loan officer, but may also be initiated by internal loan review or the Bank's loan committees at any time.

In determining the allowance and related provision, these principal elements are considered:

Specific allocations are based upon probable losses on individually evaluated impaired loans. These loans are measured based on the present value of future cash flows discounted at the loans' effective interest rate or at estimated fair value of the loans' collateral, if applicable. Other objective factors such as payment history and financial condition of the borrower or guarantor may be used as well.

Allocations for loans not defined as impaired are based on estimates for pools of loans with similar risk based upon Bancorp's historical net loss percentages by loan type.

Additional allowance allocations are based on environmental or qualitative factors not necessarily associated with a specific credit or loan category and represent management's effort to ensure that the overall allowance appropriately reflects changes in trends, conditions and other relevant factors that may cause estimated credit losses to differ from historical experience. Management considers a number of environmental or qualitative factors, including local and general economic business factors and trends and portfolio concentrations.

Allocation of the allowance by loan category is a result of the analysis above. The same procedures used to determine requirements for the allowance establish the distribution of the allowance by loan category. Distribution of the allowance will change from period to period due to changes in the identified risk in each loan segment, changes in the aggregate loan balances by loan category, and changes in management's view of the environmental or qualitative factors noted above. Although the allowance is comprised of specific and general allocations, the entire allowance is available to absorb any credit losses.

Historical net loss percentages are updated quarterly based on actual losses experienced by each loan type. Perception of risk with respect to particular loans within the portfolio will change over time as a result of characteristics and performance of those loans, overall economic and market trends, and actual and expected trends in non-performing loans. In the first quarter of 2018, Bancorp extended the historical period used to capture Bancorp's historical loss ratios from 28 quarters to 32 quarters. This extension of the historical period used to capture Bancorp's historical loss ratios was applied to all classes and segments of our loan portfolio. Expansion of the look-back period for the quantitative historical loss rate caused us to review the overall methodology for qualitative factors to ensure we were appropriately capturing risk not addressed in the quantitative historical loss rate. Management believes extension of the look-back period is appropriate to capture the impact of a full economic cycle and provides sufficient loss observations to develop a reliable estimate.

Bancorp's allowance calculation includes allocations to loan portfolio segments at December 31, 2018 for qualitative factors including, among other factors, local economic and business conditions, quality and experience of lending staff and management, exceptions to lending policies, levels of and trends in past due loans and loan classifications, concentrations of credit such as collateral type, trends in portfolio growth, trends in the value of underlying collateral for collateral-dependent loans, effect of other external factors such as the national economic and business trends, and the quality and depth of the loan review function. Bancorp utilizes the sum of all allowance amounts derived as described above as the appropriate level of allowance. Changes in criteria used in this evaluation or availability of new information could cause the allowance to be increased or decreased in future periods. Based on this quantitative and qualitative analysis, provisions (reductions) are made to the allowance. Such provisions (reductions) are reflected as a charge against (benefit to) current earnings in Bancorp's consolidated statements of income.

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Adequacy of the allowance is monitored by executive management and reported quarterly to the Audit Committee of the Board of Directors. This committee has approved the overall allowance methodology. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the adequacy of Bancorp's allowance. Such agencies may require Bancorp to make additional provisions to the allowance based upon their judgments about information available to them at the time of their examinations. As of balance sheet date, using the current model, management believes that the allowance is adequate to absorb probable inherent losses on existing loans that may become uncollectible.

In June of 2016 FASB issued ASU 2016-13, *Classification of Credit Losses on Financial Instruments*, which will significantly change the way entities recognize impairment of many financial assets by requiring immediate recognition of estimated credit losses expected to occur over the remaining life of the asset, determined at origination of the relationship. Implementation of this standard, which is required for interim and annual reporting periods beginning after December 15, 2019, could have a significant impact on the level of the allowance, capital as a result of the expected cumulative effect, and on earnings of Bancorp. See "Provision for Loan Losses" for further discussion of the allowance.

Summary of Loan and Lease Loss Experience

The following table summarizes average loans outstanding, changes in the allowance arising from loans charged off and recoveries on loans previously charged off by loan category and additions to the allowance charged (credited) to expense.

| (Dollars in thousands) | Year ended December 31, | | | | |
|---|-------------------------|-------------|-------------|-------------|-------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Average loans | \$2,519,936 | \$2,308,856 | \$2,159,153 | \$1,919,201 | \$1,773,011 |
| Balance of allowance for loan and lease losses at beginning of year | \$24,885 | \$24,007 | \$22,441 | \$24,920 | \$28,522 |
| Loans charged off | | | | | |
| Commercial and industrial | (2,404) | (1,782) | (1,216) | (4,065) | (661) |
| Construction and development, excluding undeveloped land | — | — | (133) | (26) | (250) |
| Undeveloped land | — | — | — | — | (1,753) |
| Real estate mortgage | (132) | (98) | (576) | (693) | (993) |
| Consumer | (476) | (549) | (568) | (597) | (587) |
| Total loans charged off | (3,012) | (2,429) | (2,493) | (5,381) | (4,244) |
| Recoveries of loans previously charged off | | | | | |
| Commercial and industrial | 554 | 202 | 279 | 98 | 243 |

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| | | | | | |
|--|----------|----------|----------|----------|----------|
| Construction and development, excluding undeveloped land | – | – | 21 | – | – |
| Undeveloped land | – | – | – | 1,400 | 166 |
| Real estate mortgage | 62 | 154 | 342 | 155 | 120 |
| Consumer | 340 | 401 | 417 | 499 | 513 |
| Total recoveries | 956 | 757 | 1,059 | 2,152 | 1,042 |
| Net loans charged off | (2,056) | (1,672) | (1,434) | (3,229) | (3,202) |
| Provision | 2,705 | 2,550 | 3,000 | 750 | (400) |
| Balance at end of year | \$25,534 | \$24,885 | \$24,007 | \$22,441 | \$24,920 |
| Net charge-offs to average loans | 0.08 | % 0.07 | % 0.07 | % 0.17 | % 0.18 |

See “Provision for Loan and lease Losses” for discussion of the provision for loan losses and 2018 charge-offs.

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The following table sets forth allocation of the allowance to loan categories shown. Although specific allocations exist, the entire allowance is available to absorb losses in any particular loan category.

| (In thousands) | December 31, | | | | |
|--|---------------------|-------------|-------------|-------------|-------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Commercial and industrial | \$11,965 | \$11,276 | \$10,483 | \$8,645 | \$11,819 |
| Construction and development, excluding undeveloped land | 1,760 | 1,724 | 1,923 | 1,760 | 721 |
| Undeveloped land | 752 | 521 | 684 | 814 | 1,545 |
| Real estate mortgage | 10,681 | 11,012 | 10,573 | 10,875 | 10,541 |
| Consumer | 376 | 352 | 344 | 347 | 294 |
| Total allowance | \$25,534 | \$24,885 | \$24,007 | \$22,441 | \$24,920 |

Changes in the allocation of the allowance from year to year in various categories are influenced by the level of net charge-offs in respective categories and other factors including, but not limited to, an evaluation of the impact of current economic conditions and trends, risk allocations tied to specific loans or groups of loans and changes in qualitative allocations. Management believes that allocations for each loan category are reflective of risk inherent in the portfolio.

Selected ratios relating to the allowance follow:

| | Years ended | | |
|----------------------------------|---------------------|-------------|-------------|
| | December 31, | | |
| | 2018 | 2017 | 2016 |
| Provision to average loans | 0.11 % | 0.11 % | 0.14 % |
| Net charge-offs to average loans | 0.08 | 0.07 | 0.07 |
| Allowance to average loans | 1.01 | 1.08 | 1.11 |
| Allowance to year end loans | 1.00 | 1.03 | 1.04 |

Deposits

Average amounts of deposits in Bancorp and average rates paid on such deposits for the years indicated are summarized as follows:

| Years ended December 31, | | |
|---------------------------------|-------------|-------------|
| 2018 | 2017 | 2016 |

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| (Dollars in thousands) | Average balance | Average rate | Average balance | Average rate | Average balance | Average rate |
|--------------------------------------|----------------------------|-------------------------|----------------------------|-------------------------|----------------------------|-------------------------|
| Non-interest bearing demand deposits | \$703,453 | – | \$684,044 | – | \$650,036 | – |
| Interest bearing demand deposits | 811,748 | 0.49 % | 757,023 | 0.21 % | 717,800 | 0.14 % |
| Savings deposits | 156,212 | 0.20 | 148,510 | | | |