S&T BANCORP INC
Form 10-Q
November 05, 2008
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2008

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from To

Commission file number 0-12508

S&T BANCORP, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania **(State or other jurisdiction of** **incorporation or organization)**	**25-1434426** **(IRS Employer** **Identification No.)**
800 Philadelphia Street, Indiana, PA **(Address of principal executive offices)**	**15701** **(zip code)**

800-325-2265

(Registrant s telephone number, including area code)

Not Applicable

(Former name, former address, and former fiscal year, if changed since last report)

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

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

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

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S&T BANCORP, INC. AND SUBSIDIARIES

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S&T BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

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

See notes to Condensed Consolidated Financial Statements

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S&T BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

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

Net Income	**$ 15,686**	**$ 15,661**	**$ 44,403**	**$ 42,833**
Earnings per common share:				
Net Income Basic	$ 0.57	$ 0.64	$ 1.72	$ 1.73
Net Income Diluted	0.57	0.63	1.71	1.72
Dividends declared per common share	0.31	0.30	0.93	0.90
Average Common Shares Outstanding Basic	27,417	24,529	25,764	24,798
Average Common Shares Outstanding Diluted	27,602	24,691	25,935	24,960

See notes to Condensed Consolidated Financial Statements

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S&T BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)

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

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

See Notes to Condensed Consolidated Financial Statements

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S&T BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

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

Non Cash Activities		
Transfers to other real estate owned	$ 623	$ 346
Net assets acquired in acquisition, excluding cash and cash equivalents	160,019	

See Notes to Condensed Consolidated Financial Statements

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S&T BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE A BASIS OF PRESENTATION

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

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

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

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

Certain amounts in prior years financial statements have been reclassified to conform to the current year s presentation. The reclassifications had no effect on S&T s financial condition or results of operations.

NOTE B NET INCOME PER SHARE

S&T s basic net income per share is calculated as net income divided by the weighted average number of shares outstanding. For diluted net income per share, net income is divided by the weighted average number of shares outstanding plus the incremental number of shares added as a result of converting common stock equivalents, calculated using the treasury stock method. S&T s common stock equivalents consist of outstanding stock options and restricted stock. Excluded from the calculation were anti-dilutive stock options for 551,000 and 564,000 shares for the nine months ended September 30, 2008 and 2007, respectively.

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

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

NOTE C RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued

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

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

In December 2007, FASB issued SFAS No. 141R, Business Combinations, and SFAS No. 160, Noncontrolling Interest in Consolidated Financial Statements. SFAS Nos. 141R and 160 require most identifiable assets, liabilities, noncontrolling interest, and goodwill acquired in a business combination to be recorded at full fair value and require noncontrolling interests (previously referred to as minority interests) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. SFAS Nos. 141R and 160 are effective for periods beginning on or after December 15, 2008, and earlier adoption is prohibited. SFAS No. 141R will be applied to all business entities and SFAS No. 160 will be applied prospectively to all noncontrolling interests, including any that arose before the December 15, 2008 effective date. S&T is in the process of determining the impact of applying SFAS Nos. 141R and 160 on S&T s financial position and results of operations.

NOTE D ACQUISITION

On June 6, 2008, S&T completed the acquisition of 100 percent of the voting shares of IBT Bancorp, Inc. located in Irwin, Pennsylvania, (IBT) which was the sole shareholder of Irwin Bank, in a stock and cash transaction valued at approximately $177.1 million. Pursuant to the terms of the merger agreement, shareholders of IBT were entitled to elect to receive for each share of IBT common stock that they owned, either $31.00 in cash or 0.93 of a share of S&T common stock. S&T issued 2,751,749 shares of common stock out of its treasury shares at a recorded fair value of $91.7 million based on $33.33 per share which was the closing price on May 12, 2008, the day before the IBT shareholders approved the merger and paid a total of $75.1 million in cash to the former IBT shareholders. The acquisition significantly expands S&T s market share in the growing Allegheny and Westmoreland County markets in Western Pennsylvania. The acquisition was accounted for under the purchase method, and all transactions of IBT since the acquisition date are included in S&T s consolidated financial statements.

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

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

Borrowings	160,316
Other liabilities	5,786
Total liabilities assumed	**739,703**
Net assets acquired	**$ 177,085**

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued

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

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

NOTE E FAIR VALUE

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

Fair-Value Hierarchy

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

Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect S&T s market assumptions. These two types of inputs have created the following fair-value hierarchy:

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

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

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

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

Determination of Fair Value

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

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

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued

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

Investments

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

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

S&T s U.S. government agencies and mortgage backed securities portfolio are valued based on market data. The service provider utilizes evaluated pricing models that vary based by asset class and include available trade, bid, and other market information. Generally, the methodologies include broker quotes, proprietary models, vast descriptive terms and conditions databases, as well as extensive quality control programs and are classified as Level 2.

S&T s obligations of state and political subdivisions portfolio is valued using proprietary valuation matrices from the service provider, which incorporates the recent unprecedented changes in the municipal market. The market evaluation model includes a separate curve structure for the bank-qualified versus general market municipals. For the bank-qualified municipals, the source is the service provider s own trading desk. Securities are further broken down according to insurer, credit support, state of issuance, and rating to incorporate additional spreads and municipal curves and are classified as Level 2.

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

Trading Assets

When available, S&T uses quoted market prices to determine the fair value of trading assets; such items are classified in Level 1 of the fair-value hierarchy. Since S&T s only trading account asset is a Rabbi Trust for deferred compensation plans, which is invested in two readily quoted mutual funds, the Rabbi Trust asset is classified as Level 1 and is recorded in other assets in S&T s Consolidated Balance Sheet.

Impaired Loans

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

Mortgage Servicing Rights

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued

These MSRs, which totaled $1,867,000 as of September 30, 2008, are classified as part of other assets on S&T s Consolidated Balance Sheet. Changes in fair value for MSRs are recorded in mortgage banking in S&T s Consolidated Statements of Income. MSRs are classified as Level 3 because the valuation model includes significant unobservable inputs.

Interest Rate Swaps

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

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

Items Measured at Fair Value on a Recurring Basis

The following table presents S&T s assets and liabilities that are measured at fair value on a recurring basis by fair value hierarchy level at September 30, 2008.

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

Loans Originated for Sale and Held For Sale

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

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S&T BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued

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

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

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

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

(3) *Unrealized gains (losses) on MSRs are recorded in mortgage banking noninterest income on the Condensed Consolidated Statements of Income.*

NOTE F MORTGAGE LOAN SERVICING

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

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

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

For the nine months ended September 30, 2008 and 2007, the 1-4 family mortgage loans that were sold to Fannie Mae amounted to $14.4 million and $13.0 million, respectively. At September 30, 2008 and 2007, S&T s servicing portfolio totaled $174.5 million and $178.3 million, respectively.

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

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

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

NOTE G EMPLOYEE BENEFITS

The following table summarizes the components of net periodic pension expense for S&T s defined benefit plan:

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

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

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S&T BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE H SECURITIES

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

September 30, 2008

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

December 31, 2007

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

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

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S&T BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued

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

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

September 30, 2008

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

December 31, 2007

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

The amortized cost and estimated market value of debt securities at September 30, 2008, by expected maturity, are as set forth in the following table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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

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

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

NOTE I LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the loan portfolio was as follows:

(dollars in thousands)	**September 30, 2008**	**December 31, 2007**
Real estate construction	$ 407,834	$ 329,875
Real estate mortgages:		
Residential	844,378	610,250
Commercial	1,360,054	965,770
Commercial and industrial	879,664	815,306
Consumer	86,205	74,839