COMMUNITY TRUST BANCORP INC /KY/
Form 10-Q
November 08, 2012

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

[X]	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended September 30, 2012
	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 0-11129

COMMUNITY TRUST BANCORP, INC.
(Exact name of registrant as specified in its charter)

Kentucky	61-0979818
(State or other jurisdiction of incorporation or organization)	IRS Employer Identification No.
346 North Mayo Trail Pikeville, Kentucky (address of principal executive offices)	41501 (Zip Code)

(606) 432-1414
(Registrant's telephone number)

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 ü	No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.)

Yes ü	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 definition of "accelerated filer, large accelerated filer, and smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

Yes	No ü

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

Common stock – 15,612,366 shares outstanding at October 31, 2012

CAUTIONARY STATEMENT
REGARDING FORWARD LOOKING STATEMENTS

Certain of the statements contained herein that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act. CTBI's actual results may differ materially from those included in the forward-looking statements. Forward-looking statements are typically identified by words or phrases such as "believe," "expect," "anticipate," "intend," "estimate," "may increase," "may fluctuate," and similar expressions or fu conditional verbs such as "will," "should," "would," and "could." These forward-looking statements involve risks anc uncertainties including, but not limited to, economic conditions, portfolio growth, the credit performance of the portfolios, including bankruptcies, and seasonal factors; changes in general economic conditions including the performance of financial markets, prevailing inflation and interest rates, realized gains from sales of investments, gains from asset sales, and losses on commercial lending activities; results of various investment activities; the effects of competitors' pricing policies, changes in laws and regulations, competition, and demographic changes on target market populations' savings and financial planning needs; industry changes in information technology systems on which we are highly dependent; failure of acquisitions to produce revenue enhancements or cost savings at levels or within the time frames originally anticipated or unforeseen integration difficulties; the adoption by CTBI of a Federal Financial Institutions Examination Council (FFIEC) policy that provides guidance on the reporting of delinquent consumer loans and the timing of associated credit charge-offs for financial institution subsidiaries; and the resolution of legal proceedings and related matters. In addition, the banking industry in general is subject to various monetary and fiscal policies and regulations, which include those determined by the Federal Reserve Board, the Federal Deposit Insurance Corporation, and state regulators, whose policies and regulations could affect CTBI's results. These statements are representative only on the date hereof, and CTBI undertakes no obligation to update any forward-looking statements made.

PART I - FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

The accompanying information has not been audited by our independent registered public accountants; however, in the opinion of management such information reflects all adjustments necessary for a fair presentation of the results for the interim period. All such adjustments are of a normal and recurring nature.

The accompanying condensed consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America or those normally made in the Registrant's annual report on Form 10-K. Accordingly, the reader of the Form 10-Q should refer to the Registrant's Form 10-K for the year ended December 31, 2011 for further information in this regard.

Community Trust Bancorp, Inc.
Condensed Consolidated Balance Sheets

(dollars in thousands)	(unaudited) September 30 2012	December 31 2011
Assets:		
Cash and due from banks	$59,480	$69,723
Interest bearing deposits	135,630	166,057
Federal funds sold	7,431	2,701
Cash and cash equivalents	202,541	238,481
Certificates of deposit in other banks	8,758	11,875
Securities available-for-sale at fair value (amortized cost of $598,878 and $511,731, respectively)	621,230	527,398
Securities held-to-maturity at amortized cost (fair value of $1,664 and $1,661, respectively)	1,662	1,662
Loans held for sale	771	536
Loans	2,551,537	2,556,548
Allowance for loan losses	(33,189)	(33,171)
Net loans	2,518,348	2,523,377
Premises and equipment, net	55,068	54,297
Federal Home Loan Bank stock	25,673	25,673
Federal Reserve Bank stock	4,885	4,883
Goodwill	65,490	65,490
Core deposit intangible (net of accumulated amortization of $7,659 and $7,499, respectively)	957	1,117
Bank owned life insurance	44,546	43,483
Mortgage servicing rights	2,281	2,282
Other real estate owned	56,103	56,965
Other assets	33,218	33,660
Total assets	$3,641,531	$3,591,179
Liabilities and shareholders' equity:		
Deposits		
Noninterest bearing	$599,984	$584,735
Interest bearing	2,311,860	2,293,624
Total deposits	2,911,844	2,878,359
Repurchase agreements	218,511	217,177
Federal funds purchased and other short-term borrowings	8,821	13,104
Advances from Federal Home Loan Bank	1,472	21,609
Long-term debt	61,341	61,341
Other liabilities	43,445	32,723
Total liabilities	3,245,434	3,224,313

Shareholders' equity:		
Preferred stock, 300,000 shares authorized and unissued	-	-
Common stock, $5 par value, shares authorized 25,000,000; shares outstanding 2012 – 15,604,383; 2011 – 15,429,992	78,023	77,151
Capital surplus	160,266	156,101
Retained earnings	143,279	123,431
Accumulated other comprehensive income, net of tax	14,529	10,183
Total shareholders' equity	396,097	366,866
Total liabilities and shareholders' equity	$3,641,531	$3,591,179

See notes to condensed consolidated financial statements.

Community Trust Bancorp, Inc.
Condensed Consolidated Statements of Income and Other Comprehensive Income
(unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
(in thousands except per share data)	2012	2011	2012	2011
Interest income:				
Interest and fees on loans, including loans held for sale	$34,298	$36,180	$103,628	$109,048
Interest and dividends on securities				
Taxable	3,148	2,598	9,001	7,631
Tax exempt	534	455	1,525	1,263
Interest and dividends on Federal Reserve Bank and Federal Home Loan Bank stock	345	329	1,054	1,042
Other, including interest on federal funds sold	125	146	423	425
Total interest income	38,450	39,708	115,631	119,409
Interest expense:				
Interest on deposits	4,777	5,193	14,178	16,534
Interest on repurchase agreements and other short-term borrowings	294	397	953	1,251
Interest on advances from Federal Home Loan Bank	8	23	27	77
Interest on long-term debt	325	1,000	2,102	3,000
Total interest expense	5,404	6,613	17,260	20,862
Net interest income	33,046	33,095	98,371	98,547
Provision for loan losses	2,919	2,515	6,504	10,222
Net interest income after provision for loan losses	30,127	30,580	91,867	88,325
Noninterest income:				
Service charges on deposit accounts	6,038	6,681	17,865	18,999
Gains on sales of loans, net	660	438	1,982	1,166
Trust income	1,734	1,597	5,169	4,790
Loan related fees	631	250	2,528	1,609
Bank owned life insurance	462	433	1,321	1,269
Securities gains	0	0	819	0
Other noninterest income	1,313	1,543	4,330	4,440
Total noninterest income	10,838	10,942	34,014	32,273
Noninterest expense:				
Officer salaries and employee benefits	3,048	2,087	7,727	6,597
Other salaries and employee benefits	10,237	10,153	30,773	30,444
Occupancy, net	1,969	2,013	5,681	6,043
Equipment	957	1,008	2,870	2,781
Data processing	1,644	1,550	4,771	4,992
Bank franchise tax	1,130	1,120	3,413	3,403
Legal fees	522	631	1,619	2,131
Professional fees	411	285	1,056	970
FDIC insurance	643	591	1,913	2,554

Other real estate owned provision and expense	1,123	1,465	2,672	4,497
Other noninterest expense	4,129	4,924	13,216	15,108
Total noninterest expense	25,813	25,827	75,711	79,520
Income before income taxes	15,152	15,695	50,170	41,078
Income taxes	4,943	5,030	15,860	12,139
Net income	10,209	10,665	34,310	28,939
Other comprehensive income:				
Unrealized holding gains on securities available-for-sale:				
Unrealized holding gains arising during the period	3,337	4,093	7,505	9,702
Less: Reclassification adjustments for realized gains included in net income	0	0	(819)	0
Tax expense	1,168	1,432	2,340	3,395
Other comprehensive income, net of tax	2,169	2,661	4,346	6,307
Comprehensive income	$12,378	$13,326	$38,656	$35,246
Basic earnings per share	$0.66	$0.70	$2.22	$1.89
Diluted earnings per share	$0.66	$0.70	$2.21	$1.89
Weighted average shares outstanding-basic	15,491	15,318	15,450	15,307
Weighted average shares outstanding-diluted	15,555	15,339	15,501	15,331
Dividends declared per share	$0.315	$0.310	$0.935	$0.920

See notes to condensed consolidated financial statements.

Community Trust Bancorp, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited)

	Nine Months Ended September 30	
(in thousands)	2012	2011
Cash flows from operating activities:		
Net income	$34,310	$28,939
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,212	3,123
Deferred taxes	(2,340)	(3,373)
Stock-based compensation	443	499
Excess tax benefits of stock-based compensation	495	(32)
Provision for loan losses	6,504	10,222
Write-downs of other real estate owned and other repossessed assets	899	2,890
Gains on sale of mortgage loans held for sale	(1,982)	(1,166)
Gains on sales of securities	(819)	0
Losses on sale of assets, net	101	80
Proceeds from sale of mortgage loans held for sale	89,015	53,986
Funding of mortgage loans held for sale	(87,268)	(53,191)
Amortization of securities premiums and discounts, net	4,143	2,430
Change in cash surrender value of bank owned life insurance	(1,063)	(1,051)
Death benefits received on bank owned life insurance	0	79
Mortgage servicing rights:		
Fair value adjustments	511	1,139
New servicing assets created	(510)	(378)
Changes in:		
Other assets	456	508
Other liabilities	11,088	27,492
Net cash provided by operating activities	57,195	72,196
Cash flows from investing activities:		
Certificates of deposit in other banks:		
Maturity of certificates of deposit	3,117	1,483
Securities available-for-sale (AFS):		
Purchase of AFS securities	(216,143)	(188,002)
Proceeds from prepayments and maturities of AFS securities	113,648	70,341
Proceeds from the sales of AFS securities	12,025	0
Change in loans, net	(9,118)	(2,666)
Purchase of premises and equipment	(3,823)	(2,806)
Proceeds from sale of premises and equipment	103	39
Additional investment in Federal Reserve Bank stock	(2)	(449)
Proceeds from sale of other real estate and other repossessed assets	7,915	6,437
Additional investment in other real estate and other repossessed assets	(527)	(254)
Additional investment in bank owned life insurance	0	(2,458)
Net cash used in investing activities	(92,805)	(118,335)
Cash flows from financing activities:		

Change in deposits, net	33,485	102,705
Change in repurchase agreements, federal funds purchased, and other short-term borrowings, net	(2,949)	47,390
Advances from Federal Home Loan Bank	0	571
Payments on advances from Federal Home Loan Bank	(20,137)	(151)
Issuance of common stock	4,099	1,009
Excess tax benefits of stock-based compensation	(495)	32
Dividends paid	(14,333)	(13,994)
Net cash provided by (used in) financing activities	(330)	137,562
Net increase (decrease) in cash and cash equivalents	(35,940)	91,423
Cash and cash equivalents at beginning of period	238,481	158,983
Cash and cash equivalents at end of period	$202,541	$250,406
Supplemental disclosures:		
Income taxes paid	$11,325	$8,380
Interest paid	14,303	18,841
Non-cash activities:		
Loans to facilitate the sale of other real estate and other repossessed assets	2,897	1,375
Common stock dividends accrued, paid in subsequent quarter	4,882	4,749
Real estate acquired in settlement of loans	10,540	25,551

See notes to condensed consolidated financial statements.

Community Trust Bancorp, Inc.
Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 - Summary of Significant Accounting Policies

In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments (which consist of normal recurring accruals) necessary, to present fairly the condensed consolidated financial position as of September 30, 2012, the results of operations for the three and nine months ended September 30, 2012 and 2011, and the cash flows for the nine months ended September 30, 2012 and 2011. In accordance with accounting principles generally accepted in the United States of America for interim financial information, these statements do not include certain information and footnote disclosures required by accounting principles generally accepted in the United States of America for complete annual financial statements. The results of operations for the three and nine months ended September 30, 2012 and 2011, and the cash flows for the nine months ended September 30, 2012 and 2011, are not necessarily indicative of the results to be expected for the full year. The condensed consolidated balance sheet as of December 31, 2011 has been derived from the audited consolidated financial statements of Community Trust Bancorp, Inc. ("CTBI") for that period. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2011, included in our annual report on Form 10-K.

Principles of Consolidation – The unaudited condensed consolidated financial statements include the accounts of CTBI and its separate and distinct, wholly owned subsidiaries Community Trust Bank, Inc. (the "Bank") and Community Trust and Investment Company. All significant intercompany transactions have been eliminated in consolidation.

Reclassifications – Certain reclassifications considered to be immaterial have been made in the prior year condensed consolidated financial statements to conform to current year classifications. These reclassifications had no effect on net income.

New Accounting Standards –

Ø Reconsideration of Effective Control for Repurchase Agreements – In April 2011, the FASB issued ASU 2011-03, Reconsideration of Effective Control for Repurchase Agreements. The main objective in developing this ASU was to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments in this ASU remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. Other criteria applicable to the assessment of effective control were not changed by the amendments in this Update. The guidance in this Update is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. The adoption of ASU No. 2011-03 did not have a material impact on CTBI's consolidated financial statements.

Ø Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs – In May 2011, the FASB issued ASU No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this ASU generally represent clarifications of Topic 820, but also include some instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This ASU results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and IFRSs.

The amendments in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. The adoption of this ASU did not have a material effect on our financial position or results of operations.

Ø Amendments to Topic 220, Comprehensive Income – In June 2011, the FASB issued ASU No. 2011-05, Amendments to Topic 220, Comprehensive Income. Under the amendments in this ASU, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments in this ASU do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income.

The amendments in this ASU should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The amendments do not require any transition disclosures. In October 2011, the FASB decided that the specific requirement to present items that are reclassified from other comprehensive income to net income alongside their respective components of net income and other comprehensive income will be deferred. Therefore, those requirements will not be effective for public entities for fiscal years and interim periods within those years beginning after December 15, 2011. The adoption of ASU 2011-05 did not have a material impact on our consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in ASU No. 2011-05. The amendments in this ASU supersede certain pending paragraphs in ASU No. 2011-05 to effectively defer only those changes that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. The amendments will be temporary to allow the FASB time to redeliberate the presentation requirements for reclassifications out of accumulated other comprehensive income for annual and interim financial statements for public, private, and non-profit entities.

Testing Goodwill for Impairment – In September 2011, the FASB issued ASU No. 2011-08, Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment. The amendments in this ASU will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under these amendments, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Adoption of this ASU did not have a material effect on our consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment. Under these amendments, an entity would not be required to calculate the fair value of an indefinite-lived intangible asset unless the entity determines, based on qualitative assessment, that it is not more likely than not that the indefinite-lived intangible asset is impaired. The amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. ASU 2012-02 is effective for annual and interim indefinite-lived intangible asset impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. CTBI will adopt this ASU by the date required and does not anticipate that it will have a material effect on our consolidated financial statements.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the appropriate application of certain accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in our consolidated financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences could be material to the consolidated financial statements.

We believe the application of accounting policies and the estimates required therein are reasonable. These accounting policies and estimates are constantly reevaluated, and adjustments are made when facts and circumstances dictate a change. Historically, we have found our application of accounting policies to be appropriate, and actual results have not differed materially from those determined using necessary estimates.

Our accounting policies are described above. We have identified the following critical accounting policies:

Investments – Management determines the classification of securities at purchase. We classify securities into held-to-maturity, trading, or available-for-sale categories. Held-to-maturity securities are those which we have the positive intent and ability to hold to maturity and are reported at amortized cost. In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320, Investment Securities, investments in debt securities that are not classified as held-to-maturity and equity securities that have readily determinable fair values shall be classified in one of the following categories and measured at fair value in the statement of financial position:

a. Trading securities. Securities that are bought and held principally for the purpose of selling them in the near term (thus held for only a short period of time) shall be classified as trading securities. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price.

b. Available-for-sale securities. Investments not classified as trading securities (nor as held-to-maturity securities) shall be classified as available-for-sale securities.

We do not have any securities that are classified as trading securities. Available-for-sale securities are reported at fair value, with unrealized gains and losses included as a separate component of shareholders' equity, net of tax. If declines in fair value are other than temporary, the carrying value of the securities is written down to fair value as a realized loss with a charge to income for the portion attributable to credit losses and a charge to other comprehensive income for the portion that is not credit related.

Gains or losses on disposition of securities are computed by specific identification for all securities except for shares in mutual funds, which are computed by average cost. Interest and dividend income, adjusted by amortization of purchase premium or discount, is included in earnings.

When the fair value of a security is below its amortized cost, and depending on the length of time the condition exists and the extent the fair market value is below amortized cost, additional analysis is performed to determine whether an other than temporary impairment condition exists. Available-for-sale and held-to-maturity securities are analyzed quarterly for possible other than temporary impairment. The analysis considers (i) whether we have the intent to sell our securities prior to recovery and/or maturity and (ii) whether it is more likely than not that we will not have to sell our securities prior to recovery and/or maturity. Often, the information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the security may be different than previously estimated, which could have a material effect on the CTBI's results of operations and financial condition.

Loans – Loans with the ability and the intent to be held until maturity and/or payoff are reported at the carrying value of unpaid principal reduced by unearned interest, an allowance for loan and lease losses, and unamortized deferred fees or costs. Income is recorded on the level yield basis. Interest accrual is discontinued when management believes, after considering economic and business conditions, collateral value, and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful. Any loan greater than 90 days past due must be well secured and in the process of collection to continue accruing interest. Cash payments received on nonaccrual loans generally are applied against principal, and interest income is only recorded once principal recovery is reasonably assured. Loans are not reclassified as accruing until principal and interest payments remain current for a period of time, generally six months, and future payments appear reasonably certain. Included in certain loan categories of impaired loans are troubled debt restructurings that were classified as impaired. A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.

Loan origination and commitment fees and certain direct loan origination costs are deferred and the net amount amortized over the estimated life of the related loans, leases, or commitments as a yield adjustment.

Allowance for Loan and Lease Losses – We maintain an allowance for loan and lease losses (“ALLL”) at a level that is appropriate to cover estimated credit losses on individually evaluated loans determined to be impaired, as well as estimated credit losses inherent in the remainder of the loan and lease portfolio. Since arriving at an appropriate ALLL involves a high degree of management judgment, we use an ongoing quarterly analysis to develop a range of estimated losses. In accordance with accounting principles generally accepted in the United States, we use our best estimate within the range of potential credit loss to determine the appropriate ALLL. Credit losses are charged and recoveries are credited to the ALLL.

We utilize an internal risk grading system for commercial credits. Those larger commercial credits that exhibit probable or observed credit weaknesses are subject to individual review. The borrower’s cash flow, adequacy of collateral coverage, and other options available to CTBI, including legal remedies, are evaluated. The review of individual loans includes those loans that are impaired as defined by ASC 310-35, Impairment of a Loan. We evaluate the collectability of both principal and interest when assessing the need for loss provision. Historical loss rates are analyzed and applied to other commercial loans not subject to specific allocations. The ALLL allocation for this pool of commercial loans is established based on the historical average, maximum, minimum, and median loss ratios.

A loan is considered impaired when, based on current information and events, it is probable that CTBI will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Homogenous loans, such as consumer installment, residential mortgages, and home equity lines are not individually risk graded. The associated ALLL for these loans is measured under ASC 450, Contingencies.

When any secured commercial loan is considered uncollectable, whether past due or not, a current assessment of the value of the underlying collateral is made. If the balance of the loan exceeds the fair value of the collateral, the loan is placed on non-accrual and the loan is charged down to the value of the collateral less estimated cost to sell or a specific reserve equal to the difference between book value of the loan and the fair value assigned to the collateral is created until such time as the loan is foreclosed. When the foreclosed collateral has been legally assigned to CTBI, a charge off is taken, if necessary, in order that the remaining balance reflects the fair value estimated less costs to sell of the collateral then transferred to other real estate owned or other repossessed assets. When any unsecured commercial loan is considered uncollectable the loan is charged off no later than at 90 days past due.

All closed-end consumer loans (excluding conventional 1-4 family residential loans and installment and revolving loans secured by real estate) are charged off no later than 120 days (5 monthly payments) delinquent. If a loan is considered uncollectable, it is charged off earlier than 120 days delinquent. For conventional 1-4 family residential loans and installment and revolving loans secured by real estate, when a loan is 90 days past due, a current assessment of the value of the real estate is made. If the balance of the loan exceeds the fair value of the property, the loan is placed on nonaccrual and foreclosure proceedings are initiated. When the foreclosed property has been legally assigned to CTBI, a charge-off is taken with the remaining balance, reflecting the fair value less estimated costs to sell, transferred to other real estate owned.

Historical loss rates for loans are adjusted for significant factors that, in management's judgment, reflect the impact of any current conditions on loss recognition. We generally review the historical loss rates over eight quarters and four quarters on a rolling average basis. Factors that we consider include delinquency trends, current economic conditions and trends, strength of supervision and administration of the loan portfolio, levels of underperforming loans, level of recoveries to prior year's charge-offs, trend in loan losses, industry concentrations and their relative strengths, amount of unsecured loans and underwriting exceptions. Based upon management's judgment, "best case," "worst case," and "most likely" scenarios are determined. The total of each of these weighted factors is then applied against the applicable portion of the portfolio and the ALLL is adjusted accordingly to approximate the most likely scenario. Management continually reevaluates the other subjective factors included in its ALLL analysis. During the most recent analysis, management increased several of these subjective factors including trends in past dues, trends in losses, and current economic and regulatory conditions impacting business and individual customers in our geographic markets. The cumulative effect of all of the changes increased the amount calculated for our "most likely" scenario by $3.2 million at September 30, 2012.

Other Real Estate Owned – When foreclosed properties are acquired, appraisals are obtained and the properties are booked at the current market value less expected sales costs. Additionally, periodic updated appraisals are obtained on unsold foreclosed properties. When an updated appraisal reflects a market value below the current book value, a charge is booked to current earnings to reduce the property to its new market value less expected sales costs. Our policy for determining the frequency of periodic reviews is based upon consideration of the specific properties and the known or perceived market fluctuations in a particular market and is typically between 12 and 18 months. All revenues and expenses related to the carrying of other real estate owned are recognized by a charge to income.

Note 2 – Stock-Based Compensation

CTBI's compensation expense related to stock option grants was $59 thousand and $72 thousand for the nine months ended September 30, 2012 and 2011, respectively. Restricted stock expense for the first nine months of 2012 and 2011 was $475 thousand and $517 thousand, respectively, including $91 thousand and $90 thousand, respectively, in dividends paid for each quarter. As of September 30, 2012, there was a total of $26 thousand of unrecognized compensation expense related to unvested stock option awards that will be recognized as expense as the awards vest over a weighted average period of 0.5 years and a total of $1.3 million of unrecognized compensation expense related to restricted stock grants that will be recognized as expense as the awards vest over a weighted average period of 1.5 years.

There were no shares of restricted stock granted during the three months ended September 30, 2012 and 2011, and 331 shares and 45,452 shares granted during the nine months ended September 30, 2012 and 2011, respectively. The restrictions on the restricted stock for 2012 and 2011 will lapse over four years and at the end of five years, respectively. However, in the event of a change in control of CTBI or the death of the participant, the restrictions will lapse. In the event of the disability of the participant, the restrictions will lapse on a pro rata basis. The Compensation Committee of the Board of Directors will have discretion to review and revise restrictions applicable to a participant's restricted stock in the event of the participant's retirement. There were no options granted to purchase shares of CTBI common stock during the nine months ended September 30, 2012 or 2011.

Note 3 – Securities

Securities are classified into held-to-maturity and available-for-sale categories. Held-to-maturity (HTM) securities are those that CTBI has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale (AFS) securities are those that CTBI may decide to sell if needed for liquidity, asset-liability management or other reasons. Available-for-sale securities are reported at fair value, with unrealized gains or losses included as a separate component of equity, net of tax.

The amortized cost and fair value of securities at September 30, 2012 are summarized as follows:

Available-for-Sale

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and government agencies	$26,139	$516	$0	$26,655
State and political subdivisions	99,766	5,627	(29)	105,364
U.S. government sponsored agency mortgage-backed securities	437,391	15,472	(132)	452,731
Total debt securities	563,296	21,615	(161)	584,750
Marketable equity securities	35,582	1,101	(203)	36,480
Total available-for-sale securities	$598,878	$22,716	$(364)	$621,230

Held-to-Maturity

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and government agencies	$480	$1	$0	$481
State and political subdivisions	1,182	1	0	1,183
Total held-to-maturity securities	$1,662	$2	$0	$1,664

The amortized cost and fair value of securities as of December 31, 2011 are summarized as follows:

Available-for-Sale

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and government agencies	$32,077	$1,171	$0	$33,248
State and political subdivisions	68,358	3,816	(30)	72,144
U.S. government sponsored agency mortgage-backed securities	390,714	10,186	(57)	400,843
Total debt securities	491,149	15,173	(87)	506,235
Marketable equity securities	20,582	718	(137)	21,163
Total available-for-sale securities	$511,731	$15,891	$(224)	$527,398

Held-to-Maturity

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and government agencies	$480	$0	$(1)	$479
State and political subdivisions	1,182	0	0	1,182
Total held-to-maturity securities	$1,662	$0	$(1)	$1,661

The amortized cost and fair value of securities at September 30, 2012 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale		Held-to-Maturity	
(in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$6,598	$6,688	$0	$0
Due after one through five years	21,375	22,377	0	0
Due after five through ten years	64,291	67,275	1,662	1,664
Due after ten years	33,641	35,679	0	0
U.S. government sponsored agency mortgage-backed securities	437,391	452,731	0	0
Total debt securities	563,296	584,750	1,662	1,664
Marketable equity securities	35,582	36,480	0	0
Total securities	$598,878	$621,230	$1,662	$1,664

As of September 30, 2012, there was a combined gain of $819 thousand due to the sale of two agency securities. A pre-tax gain of $885 thousand and a pre-tax loss of $66 thousand were realized as of September 30, 2012. There were no gains or losses during the nine months ended September 30, 2011.

The amortized cost of securities pledged as collateral, to secure public deposits and for other purposes, was $233.7 million at September 30, 2012 and $198.6 million at December 31, 2011.

The amortized cost of securities sold under agreements to repurchase amounted to $238.8 million at September 30, 2012 and $217.2 million at December 31, 2011.

Certain investments in debt and marketable equity securities are reported in the financial statements at amounts less than their historical costs. CTBI evaluates its investment portfolio on a quarterly basis for impairment. The analysis performed as of September 30, 2012 indicates that all impairment is considered temporary, market driven, and not credit-related. The percentage of total investments with unrealized losses as of September 30, 2012 was 3.4% compared to 4.8% as of December 31, 2011. The following tables provide the amortized cost, gross unrealized losses, and fair market value, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position as of September 30, 2012 that are not deemed to be other-than-temporarily impaired.

Available-for-Sale

(in thousands)	Amortized Cost	Gross Unrealized Losses	Fair Value
Less Than 12 Months			
State and political subdivisions	$4,615	$(29)	$4,586
U.S. government sponsored agency mortgage-backed securities	16,617	(132)	16,485
Total debt securities	21,232	(161)	21,071
Total <12 months temporarily impaired AFS securities	21,232	(161)	21,071
12 Months or More			
Marketable equity securities	329	(203)	126

Total ≥12 months temporarily impaired AFS securities	329	(203)	126
Total			
State and political subdivisions	4,615	(29)	4,586
U.S. government sponsored agency mortgage-backed securities	16,617	(132)	16,485
Total debt securities	21,232	(161)	21,071
Marketable equity securities	329	(203)	126
Total temporarily impaired AFS securities	$21,561	$(364)	$21,197

As of September 30, 2012, there were no held-to-maturity securities with unrealized losses.

The analysis performed as of December 31, 2011 indicated that all impairment was considered temporary, market driven, and not credit-related. The following tables provide the amortized cost, gross unrealized losses, and fair market value, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position as of December 31, 2011 that are not deemed to be other-than-temporarily impaired.

Available-for-Sale

(in thousands)	Amortized Cost	Gross Unrealized Losses	Fair Value
Less Than 12 Months			
State and political subdivisions	$6,173	$(25)	$6,148
U.S. government sponsored agency mortgage-backed securities	17,900	(57)	17,843
Total debt securities	24,073	(82)	23,991
Total <12 months temporarily impaired AFS securities	24,073	(82)	23,991
12 Months or More			
State and political subdivisions	613	(5)	608
Total debt securities	613	(5)	608
Marketable equity securities	329	(137)	192
Total ≥12 months temporarily impaired AFS securities	942	(142)	800
Total			
State and political subdivisions	6,786	(30)	6,756
U.S. government sponsored agency mortgage-backed securities	17,900	(57)	17,843
Total debt securities	24,686	(87)	24,599
Marketable equity securities	329	(137)	192
Total temporarily impaired AFS securities	$25,015	$(224)	$24,791

Held-to-Maturity

(in thousands)	Amortized Cost	Gross Unrealized Losses	Fair Value
Less Than 12 Months			
U.S. Treasury and government agencies	$480	$(1)	$479
Total temporarily impaired HTM securities	$480	$(1)	$479

Note 4 – Loans

Major classifications of loans, net of unearned income and deferred loan origination costs, are summarized as follows:

(in thousands)	September 30 2012	December 31 2011
Commercial construction	$115,091	$120,577
Commercial secured by real estate	820,925	798,887
Equipment lease financing	10,167	9,706

Commercial other	379,308	374,597
Real estate construction	54,431	53,534
Real estate mortgage	664,329	650,075
Home equity	82,724	84,841
Consumer direct	126,005	123,949
Consumer indirect	298,557	340,382
Total loans	$2,551,537	$2,556,548

CTBI has segregated and evaluates its loan portfolio through nine portfolio segments. The nine segments are commercial construction, commercial secured by real estate, equipment lease financing, commercial other, real estate construction, real estate mortgage, home equity, consumer direct, and consumer indirect. CTBI serves customers in small and mid-sized communities in eastern, northeastern, central, and south central Kentucky, southern West Virginia, and northeastern Tennessee. Therefore, CTBI's exposure to credit risk is significantly affected by changes in these communities.

Commercial construction loans are for the purpose of erecting or rehabilitating buildings or other structures for commercial purposes, including any infrastructure necessary for development. Included in this category are improved property, land development, and tract development loans. The terms of these loans are generally short-term with permanent financing upon completion.

Commercial real estate loans include loans secured by nonfarm, nonresidential properties, 1-4 family/ multi-family properties, farmland, and other commercial real estate. These loans are originated based on the borrower's ability to service the debt and secondarily based on the fair value of the underlying collateral.

Equipment lease financing loans are fixed, variable, and tax exempt leases for commercial purposes.

Commercial other loans consist of commercial check loans, agricultural loans, receivable financing, floorplans, loans to financial institutions, loans for purchasing or carrying securities, and other commercial purpose loans. Commercial loans are underwritten based on the borrower's ability to service debt from the business's underlying cash flows. As a general practice, we obtain collateral such as real estate, equipment, or other assets, although such loans may be uncollateralized but guaranteed.

Real estate construction loans are typically for owner-occupied properties. The terms of these loans are generally short-term with permanent financing upon completion.

Residential real estate loans are a mixture of fixed rate and adjustable rate first and second lien residential mortgage loans. As a policy, CTBI holds adjustable rate loans and sells the majority of its fixed rate first lien mortgage loans into the secondary market. Changes in interest rates or market conditions may impact a borrower's ability to meet contractual principal and interest payments. Residential real estate loans are secured by real property.

Home equity lines are revolving adjustable rate credit lines secured by real property.

Consumer direct loans are fixed rate products comprised of unsecured loans, consumer revolving credit lines, deposit secured loans, and all other consumer purpose loans.

Consumer indirect loans are fixed rate loans secured by automobiles, trucks, vans, and recreational vehicles originated at the selling dealership underwritten and purchased by CTBI's indirect lending department. Both new and used products are financed. Only dealers who have executed dealer agreements with CTBI participate in the indirect lending program.

Not included in the loan balances above were loans held for sale in the amount of $0.8 million at September 30, 2012 and $0.5 million at December 31, 2011. The amount of capitalized fees and costs under ASC 310-20, included in the above loan totals were $0.6 million and $0.7 million at September 30, 2012 and December 31, 2011, respectively.

CTBI acquired loans through the acquisition of First National Bank of LaFollette in the fourth quarter 2010. At acquisition, the transferred loans with evidence of deterioration of credit quality since origination were not significant; therefore, none of the loans acquired were accounted for under the guidance in ASC 310-30.

Credit discounts representing principal losses expected over the life of the loans are a component of the initial fair value for purchased loans acquired that are not deemed impaired at acquisition. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date. Subsequent to the acquisition date, the methods used to estimate the required allowance for credit losses for these loans is similar to originated loans; however, CTBI records a provision for loan losses only when the required allowance exceeds any remaining credit discounts. During the third quarter, the credit portion of the purchase accounting allocation was exhausted leaving only the premium paid for market rate adjustments to be amortized over the life of the remaining loans. The carrying amounts of those loans included in the balance sheet are $74.0 million and $88.5 million at September 30, 2012 and December 31, 2011, respectively. Provision expense charged to income during the quarter as a result of this change was $0.6 million.

Changes in accretable yield for the nine months ended September 30, 2012 and the year ended December 31, 2011 are as follows:

(in thousands)	September 30 2012	December 31 2011
Beginning balance	$720	$2,995
Accretion	(580)	(1,067)
Disposals	(140)	(1,208)
Ending balance	$0	$720

Refer to note 1 to the condensed consolidated financial statements for further information regarding our nonaccrual policy. Nonaccrual loans segregated by class of loans were as follows:

(in thousands)	September 30 2012	December 31 2011
Commercial:		
Commercial construction	$7,200	$7,029
Commercial secured by real estate	5,741	9,810
Commercial other	1,823	3,914
Residential:		
Real estate construction	315	607
Real estate mortgage	2,762	4,204
Home equity	257	189
Total nonaccrual loans	$18,098	$25,753

The following tables present CTBI's loan portfolio aging analysis, segregated by class, as of September 30, 2012 and December 31, 2011:

	September 30, 2012						
(in thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	90+ and Accruing*
Commercial:							
Commercial construction	$761	$0	$8,187	$8,948	$106,143	$115,091	$1,125
Commercial secured by real estate	3,954	2,197	11,363	17,514	803,411	820,925	5,741
Equipment lease financing	0	0	0	0	10,167	10,167	0
Commercial other	1,798	194	5,368	7,360	371,948	379,308	3,977
Residential:							
Real estate construction	212	75	607	894	53,537	54,431	292
Real estate mortgage	1,914	4,186	5,877	11,977	652,352	664,329	3,932
Home equity	1,270	175	584	2,029	80,695	82,724	353
Consumer:							
Consumer direct	1,710	342	109	2,161	123,844	126,005	109
Consumer indirect	2,542	676	400	3,618	294,939	298,557	399
Total	$14,161	$7,845	$32,495	$54,501	$2,497,036	$2,551,537	$15,928

	December 31, 2011						
(in thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	90+ and Accruing*
Commercial:							
Commercial construction	$362	$33	$10,171	$10,566	$110,011	$120,577	$3,292
Commercial secured by real estate	4,566	2,978	11,998	19,542	779,345	798,887	3,969
Equipment lease financing	0	0	0	0	9,706	9,706	0
Commercial other	2,286	688	2,504	5,478	369,119	374,597	619
Residential:							
Real estate construction	305	91	622	1,018	52,516	53,534	16
Real estate mortgage	2,067	4,974	6,547	13,588	636,487	650,075	2,719
Home equity	968	312	482	1,762	83,079	84,841	346
Consumer:							
Consumer direct	1,723						