S&T BANCORP INC
Form 10-Q
August 01, 2018
UNITED STATES
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 June 30, 2018
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	25-1434426
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
800 Philadelphia Street, Indiana, PA	15701
(Address of principal executive offices)	(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 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 (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange 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 - 35,008,546 shares as of July 31, 2018

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S&T BANCORP, INC. AND SUBSIDIARIES

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S&T BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(dollars in thousands, except per share data)	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
ASSETS		
Cash and due from banks, including interest-bearing deposits of $81,210 and $61,965 at June 30, 2018 and December 31, 2017	$137,933	$117,152
Securities, at fair value	688,341	698,291
Loans held for sale	3,801	4,485
Portfolio loans, net of unearned income	5,786,118	5,761,449
Allowance for loan losses	(60,517)	(56,390)
Portfolio loans, net	5,725,601	5,705,059
Bank owned life insurance	73,122	72,150
Premises and equipment, net	40,889	42,702
Federal Home Loan Bank and other restricted stock, at cost	35,782	29,270
Goodwill	287,446	291,670
Other intangible assets, net	2,909	3,677
Other assets	101,522	95,799
Total Assets	$7,097,346	$7,060,255
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$1,410,211	$1,387,712
Interest-bearing demand	553,729	603,141
Money market	1,267,623	1,146,156
Savings	845,526	893,119
Certificates of deposit	1,316,444	1,397,763
Total Deposits	5,393,533	5,427,891
Securities sold under repurchase agreements	44,724	50,161
Short-term borrowings	600,000	540,000
Long-term borrowings	46,062	47,301
Junior subordinated debt securities	45,619	45,619
Other liabilities	60,275	65,252
Total Liabilities	6,190,213	6,176,224
SHAREHOLDERS' EQUITY		
Common stock ($2.50 par value)		
Authorized—50,000,000 shares		
Issued—36,130,480 shares at June 30, 2018 and December 31, 2017	90,326	90,326
Outstanding— 35,009,945 shares at June 30, 2018 and 34,971,929 shares at December 31, 2017		
Additional paid-in capital	216,885	216,106
Retained earnings	662,112	628,107
Accumulated other comprehensive (loss) income	(30,945)	(18,427)
Treasury stock (1,120,535 shares at June 30, 2018 and 1,158,551 shares at December 31, 2017, at cost)	(31,245)	(32,081)

Total Shareholders’ Equity	907,133	884,031
Total Liabilities and Shareholders’ Equity	$7,097,346	$7,060,255

See Notes to Consolidated Financial Statements

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S&T BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(dollars in thousands, except per share data)	2018	2017	2018	2017
INTEREST INCOME				
Loans, including fees	$66,610	$60,558	$129,665	$117,458
Investment Securities:				
Taxable	3,519	2,947	6,948	5,796
Tax-exempt	872	928	1,746	1,848
Dividends	580	481	1,251	963
Total Interest Income	71,581	64,914	139,610	126,065
INTEREST EXPENSE				
Deposits	9,166	5,976	17,012	11,355
Borrowings and junior subordinated debt securities	4,012	2,368	7,264	4,261
Total Interest Expense	13,178	8,344	24,276	15,616
NET INTEREST INCOME	58,403	56,570	115,334	110,449
Provision for loan losses	9,345	4,869	11,817	10,052
Net Interest Income After Provision for Loan Losses	49,058	51,701	103,517	100,397
NONINTEREST INCOME				
Net gain (loss) on sale of securities	—	3,617	—	3,987
Debit and credit card	3,309	3,042	6,347	5,885
Service charges on deposit accounts	3,227	2,997	6,468	6,012
Wealth management	2,616	2,428	5,298	4,831
Mortgage banking	831	675	1,432	1,408
Insurance	134	1,458	303	2,913
Gain on sale of a majority interest of insurance business	—	—	1,873	—
Other	2,134	2,048	4,323	4,225
Total Noninterest Income	12,251	16,265	26,044	29,261
NONINTEREST EXPENSE				
Salaries and employee benefits	18,611	19,903	37,426	40,444
Net occupancy	2,804	2,751	5,677	5,566
Data processing and information technology	2,379	2,163	4,704	4,386
Furniture, equipment and software	2,134	1,810	4,090	3,857
Other taxes	1,739	1,083	3,587	2,060
Marketing	1,190	948	1,892	1,702
Professional services and legal	888	931	1,939	1,999
FDIC insurance	739	1,185	1,847	2,308
Other	5,379	5,823	10,783	11,084
Total Noninterest Expense	35,863	36,597	71,945	73,406
Income Before Taxes	25,446	31,369	57,616	56,252
Provision for income taxes	4,010	8,604	10,017	15,299
Net Income	$21,436	$22,765	$47,599	$40,953
Earnings per share—basic	$0.62	$0.66	$1.37	$1.18
Earnings per share—diluted	$0.61	$0.65	$1.36	$1.17
Dividends declared per share	$0.25	$0.20	$0.47	$0.40
Comprehensive Income	$20,444	$22,503	$35,081	$41,879

See Notes to Consolidated Financial Statements

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S&T BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)

(dollars in thousands, except share and per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)/Income	Treasury Stock	Total
Balance at January 1, 2017	$90,326	$213,098	$585,891	$ (13,784)	$(33,575)	$841,956
Net income for six months ended June 30, 2017	—	—	40,953	—	—	40,953
Other comprehensive income (loss), net of tax	—	—	—	926	—	926
Cash dividends declared ($0.40 per share)	—	—	(13,927)	—	—	(13,927)
Treasury stock issued for restricted awards (89,351 shares, net of 22,094 forfeitures)	—	—	(2,413)	—	1,724	(689)
Recognition of restricted stock compensation expense	—	1,843	—	—	—	1,843
Balance at June 30, 2017	$90,326	$214,941	$610,504	$ (12,858)	$(31,851)	$871,062
Balance at January 1, 2018	$90,326	$216,106	$628,107	$ (18,427)	$(32,081)	$884,031
Net income for six months ended June 30, 2018	—	—	47,599	—	—	47,599
Other comprehensive income (loss), net of tax	—	—	—	(8,229)	—	(8,229)
Reclassification of tax effects from the Tax Act[1]	—	—	3,427	(3,427)	—	—
Reclassification of net unrealized gains on equity securities[2]	—	—	862	(862)	—	—
Cash dividends declared ($0.47 per share)	—	—	(16,391)	—	—	(16,391)
Treasury stock issued for restricted awards (75,608 shares, net of 37,592 forfeitures)	—	—	(1,492)	—	836	(656)
Recognition of restricted stock compensation expense	—	779	—	—	—	779
Balance at June 30, 2018	$90,326	$216,885	$662,112	$ (30,945)	$(31,245)	$907,133

See Notes to Consolidated Financial Statements

[1]Reclassification due to the adoption of ASU No. 2018-02 - $(3,660) relates to funded status of pension and $233 relates to net unrealized gains on available-for-sale securities.

[2]Reclassification due to the adoption of ASU No. 2016-01.

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S&T BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
(dollars in thousands)	2018	2017
OPERATING ACTIVITIES		
Net income	$47,599	$40,953
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	11,817	10,052
Recovery for unfunded loan commitments	(114)	(334)
Net depreciation, amortization and accretion	2,174	850
Net amortization of discounts and premiums on securities	1,572	2,030
Stock-based compensation expense	779	1,843
Net (gain) loss on sale of securities	—	(3,987)
Mortgage loans originated for sale	(41,631)	(38,899)
Proceeds from the sale of mortgage loans	42,998	38,041
Gain on the sale of mortgage loans, net	(683)	(719)
Gain on the sale of majority interest of insurance business	(1,873)	—
Net increase in interest receivable	(520)	(666)
Net increase in interest payable	699	246
Net (increase) decrease in other assets	(853)	4,484
Net increase (decrease) in other liabilities	2,529	(1,775)
Net Cash Provided by Operating Activities	64,493	52,119
INVESTING ACTIVITIES		
Purchases of securities	(54,481)	(36,604)
Proceeds from maturities, prepayments and calls of securities	45,487	35,256
Proceeds from sales of securities	—	7,751
Net (purchases) sales of Federal Home Loan Bank stock	(6,512)	1,600
Net increase in loans	(37,957)	(176,768)
Proceeds from sale of loans not originated for resale	3,922	3,581
Purchases of premises and equipment	(804)	(3,018)
Proceeds from the sale of premises and equipment	110	273
Proceeds from the sale of majority interest of insurance business	4,540	—
Net Cash Used in Investing Activities	(45,695)	(167,929)
FINANCING ACTIVITIES		
Net increase in core deposits	46,962	44,914
Net (decrease) increase in certificates of deposit	(81,255)	92,427
Net decrease in securities sold under repurchase agreements	(5,437)	(4,343)
Net increase (decrease) in short-term borrowings	60,000	(15,000)
Repayments of long-term borrowings	(1,239)	(1,195)
Treasury shares issued-net	(657)	(689)
Cash dividends paid to common shareholders	(16,391)	(13,927)
Net Cash Provided by Financing Activities	1,983	102,187
Net increase (decrease) in cash and cash equivalents	20,781	(13,623)
Cash and cash equivalents at beginning of period	117,152	139,486
Cash and Cash Equivalents at End of Period	$137,933	$125,863
Supplemental Disclosures		

Loans transferred to held for sale	$3,922	$17,750
Interest paid	$23,576	$15,369
Income taxes paid, net of refunds	$11,103	$13,399
Transfer net assets to investment in insurance company partnership	$1,917	$—
Transfers to other real estate owned and other repossessed assets	$2,841	$1,407

See Notes to Consolidated Financial Statements

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S&T BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION
Principles of Consolidation
The interim Consolidated Financial Statements include the accounts of S&T Bancorp, Inc., or S&T, and its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation. Investments of 20 percent to 50 percent of the outstanding common stock of investees are accounted for using the equity method of accounting.
Basis of Presentation
The accompanying unaudited interim Consolidated Financial Statements of S&T have been prepared in accordance with generally accepted accounting principles, or 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 financial statements and should be read in conjunction with the audited consolidated financial statements included in our annual report on Form 10-K for the year ended December 31, 2017, filed with the Securities and Exchange Commission, or SEC, on March 1, 2018. In the opinion of management, the accompanying interim financial information reflects all adjustments, consisting of normal recurring adjustments, necessary to present fairly our financial position and the results of operations for each of the interim periods presented. Results of operations for interim periods are not necessarily indicative of the results of operations that may be expected for a full year or any future period.
On January 1, 2018, we sold a 70 percent majority interest in the assets of our wholly-owned subsidiary S&T Evergreen Insurance, LLC. We transferred our remaining ownership interest in the net assets of S&T Evergreen Insurance, LLC for a 30 percent ownership interest in a new partnership entity (see Note 13: Sale of a Majority Interest of Insurance Business). We use the equity method of accounting to recognize our partial ownership interest in the new entity.
Reclassification
Amounts in prior period financial statements and footnotes are reclassified whenever necessary to conform to the current period presentation. Reclassifications had no effect on our results of operations or financial condition.
Use of Estimates
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.
Recently Adopted Accounting Standards Updates, or ASU or Update
Income Statement - Reporting Comprehensive Income - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income
In February 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220), Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The amendments in this Update allow a reclassification from accumulated other comprehensive income, or AOCI, to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act, or Tax Act. The amendments eliminate the stranded tax effects resulting from the Tax Act and will improve the usefulness of information reported to financial statement users and will require certain disclosures about the stranded tax effects. This Update is effective for all entities for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period, for public business entities for reporting periods for which financial statements have not been issued or made available for issuance. We have elected to reclassify all tax effects related to the Tax Act from AOCI to retained earnings as of January 1, 2018. As such, we have early adopted this Update and reclassified $3.4 million for the release of stranded income tax effects relating to unrealized gains and losses on our securities portfolio and our pension plan from AOCI to retained earnings as of March 31, 2018. The adoption of this ASU had no impact on our Consolidated Statements of Comprehensive Income. Our policy for releasing income tax

effects from AOCI is to release them as investments are sold or mature and liabilities are extinguished.

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S&T BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

NOTE 1. BASIS OF PRESENTATION - continued

Compensation - Retirement Benefits - Improving the Presentation of Net Periodic Pension Costs and Net Periodic Post Retirement Benefit Costs
In March 2017, the FASB issued ASU No. 2017-07, Compensation Retirement Benefits - Improving the Presentation of Net Periodic Pension Costs and Net Periodic Post Retirement Benefit Costs (Topic 715). The main objective of this ASU is to provide financial statement users with clearer and disaggregated information related to the components of net periodic benefit cost and improve transparency of the presentation of net periodic benefit cost in the financial statements. This Update was effective for interim and annual reporting periods in fiscal years beginning after December 15, 2017. Early adoption was permitted as of the beginning of an annual period for which financial statements have not been issued or made available for issuance. Effective March 31, 2016, our qualified and nonqualified defined benefit plans were amended to freeze benefit accruals for all persons entitled to benefits under the plan; as such, the adoption of this ASU had no impact on our Consolidated Balance Sheets or Consolidated Statements of Comprehensive Income.
Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets - Clarifying the Scope of Assets Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets
In February 2017, the FASB issued ASU No. 2017-05, Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20). The main objective of this ASU is to provide greater detail on what types of transactions should be accounted for as partial sales of nonfinancial assets. This ASU, as originally issued in ASU No. 2014-09, is intended to reduce the complexity of current GAAP requirements by clarifying which accounting guidance applies to various types of contracts that transfer assets or ownership interest to another entity. This Update was effective for interim and annual reporting periods in fiscal years beginning after December 15, 2017 and at the same time that ASU No. 2014-09 was effective. Early adoption was permitted, but only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The adoption of this ASU was applied to the partial sale of our insurance subsidiary in January 2018. As such, the subsidiary is no longer included in our consolidated financial statements and we recognized a $1.9 million gain on the transaction.
Business Combinations - Clarifying the Definition of a Business
In January 2017, the FASB issued ASU No. 2017-01, Business Combinations - Clarifying the Definition of a Business (Topic 805). The main objective of this ASU is to help financial statement preparers evaluate whether a set of transferred assets and activities (either acquired or disposed of) is a business under Topic 805, Business Combinations by changing the definition of a business. The revised definition results in fewer acquisitions being accounted for as business combinations than under previous guidance. The definition of a business is significant because it affects the accounting for acquisitions, the identification of reporting units, consolidation evaluations and the accounting for dispositions. This Update was effective for interim and annual reporting periods in fiscal years beginning after December 15, 2017. Early adoption was permitted for transactions not yet reflected in financial statements that have been issued or made available for issuance. The adoption of this ASU had no impact on our Consolidated Balance Sheets or Consolidated Statements of Comprehensive Income.
Income Taxes - Intra-Entity Transfers of Assets Other Than Inventory
In October 2016, the FASB issued ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory. The main objective of this ASU is to require companies to recognize the income tax effects of intercompany sales and transfers of assets other than inventory in the period in which the transfer occurs. This represents a change from previous guidance, which required companies to defer the income tax effects of intercompany transfers of assets until the asset has been sold to an outside party or otherwise recognized. The new guidance requires companies to defer the income tax effects only of intercompany transfers of inventory. This Update was effective for annual periods beginning after December 15, 2017. Early adoption was permitted as of the beginning of an annual period. If an entity chose to early adopt the amendments in the ASU, it had to do so in the first interim period of its annual financial

statements. That is, an entity could not have adopted the amendments in the ASU in a later interim period and apply them as if they were in effect as of the beginning of the year. The adoption of this ASU had no impact on our Consolidated Balance Sheets or Consolidated Statements of Comprehensive Income.

Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. The main objective of this ASU is to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The amendments in this Update provide guidance on the following eight specific cash flow issues: debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business

S&T BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

NOTE 1. BASIS OF PRESENTATION - continued

combination, proceeds from the settlement of insurance claims, proceeds from the settlement of bank-owned life insurance (BOLI) policies, distributions received from equity method investments, beneficial interests in securitization transactions, and separately identifiable cash flows and application of the predominance principle. This Update was effective for interim and annual reporting periods in fiscal years beginning after December 15, 2017. Early adoption was permitted, provided that all of the amendments are adopted in the same period. The adoption of this ASU had no material impact to the presentation of activities in our Consolidated Statements of Cash Flows.

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). This revenue pronouncement established a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and superseded most previous revenue recognition guidance in GAAP. We adopted the new standard January 1, 2018. Our primary sources of revenue are derived from interest and dividends earned on loans, investment securities and other financial instruments that are not within the scope of ASU No. 2014-09. We evaluated the nature of our contracts with customers and related revenue streams, including service charges on deposit accounts, debit and credit cards and wealth management and determined that revenue recognition did not change significantly from current practice. We evaluated certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue. The adoption of this ASU had no material impact on our Consolidated Balance Sheets or Consolidated Statements of Comprehensive Income.

Accounting for Financial Instruments - Overall: Classification and Measurement

In January 2016, the FASB issued ASU No. 2016-01, Accounting for Financial Instruments - Overall: Classification and Measurement (Subtopic 825-10). The amendments in this ASU address the following: 1. require equity investments to be measured at fair value with changes in fair value recognized in net income; 2. simplify the impairment assessment of equity investments without readily-determinable fair values by requiring a qualitative assessment to identify impairment; 3. eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; 4. require entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; 5. require separate presentation in other comprehensive income for the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; 6. require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or in the accompanying notes to the financial statements; and 7. clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. This ASU was effective for annual and interim periods in fiscal years beginning after December 15, 2017. We adopted ASU No. 2016-01 as of January 1, 2018 and have concluded that the provisions of this ASU did not materially impact our Balance Sheets or Statements of Comprehensive Income. The new guidance resulted in a change in the fair value measurement of our loan portfolio as of March 31, 2018 using an exit price notion (see Note 3: Fair Value Measurements). The new guidance also resulted in a cumulative-effect adjustment of $0.9 million from AOCI to retained earnings at January 1, 2018 for net unrealized gains on our marketable equities portfolio. As a result of the new guidance, we recognized $0.3 million of net unrealized gains in our Consolidated Statements of Comprehensive Income during the six months ended June 30, 2018 on our marketable equity securities portfolio.

Accounting Standards Issued But Not Yet Adopted

Leases - Land Easement Practical Expedient for Transition to Topic 842

In January 2018, the FASB issued ASU No. 2018-01, Leases - Land Easement Practical Expedient for Transition to Topic 842. The amendments in this ASU permit an entity to elect an optional transition practical expedient to not evaluate under Topic 842 land easements, that existed or expired before the entity's adoption of Topic 842 and that were not previously accounted for as leases under Topic 840. This ASU is effective for annual and interim periods in fiscal years beginning after December 15, 2018. We are evaluating the amendments in this ASU; however, we do not anticipate that these amendments will materially impact our Consolidated Balance Sheets or Consolidated Statements of Comprehensive Income.

S&T BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

NOTE 1. BASIS OF PRESENTATION - continued

Intangibles - Goodwill and Other - Simplifying the Test for Goodwill Impairment
In January 2017, the FASB issued ASU No. 2017-04, Intangibles - Goodwill and Other - Simplifying the Test for Goodwill Impairment (Topic 350). The main objective of this ASU is intended to simplify the current requirements for testing goodwill for impairment by eliminating step two from the goodwill impairment test. The amendments are expected to reduce the complexity and costs associated with performing the goodwill impairment test, which could result in recording impairment charges sooner than under the current guidance. This Update is effective for any interim and annual impairment tests in reporting periods in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are evaluating the provisions of this ASU; however, we do not anticipate that this ASU will materially impact our Consolidated Balance Sheets or Consolidated Statements of Comprehensive Income.
Financial Instruments - Credit Losses
In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments. The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendments of this Update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to form credit loss estimates. The collective changes to the recognition and measurement accounting standards for financial instruments and their anticipated impact on the allowance for credit losses modeling have been universally referred to as CECL, or current expected credit loss, model. This Update is effective for interim and annual reporting periods in fiscal years beginning after December 15, 2019. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We have created a CECL Committee to govern the implementation of these amendments consisting of key stakeholders from Credit Administration, Finance, Risk Management and Internal Audit. We have engaged a third-party to assist us in developing our CECL methodology. We continue to evaluate the provisions of this ASU to determine the potential impact on our Consolidated Balance Sheets and Consolidated Statements of Comprehensive Income.
Leases - Section A-Amendments to the FASB Accounting Standards Codification, Section B-Conforming Amendments Related to Leases and Section C-Background Information and Basis for Conclusions
In February 2016, the FASB issued ASU No. 2016-02, Leases, which requires lessees to recognize a right-to-use asset and a lease obligation for all leases on the balance sheet. Lessor accounting remains substantially similar to current GAAP. ASU No. 2016-02 supersedes Topic 840, Leases. This ASU is effective for annual and interim periods in fiscal years beginning after December 15, 2018. ASU No. 2016-02 mandates a modified retrospective transition method for all entities. Early adoption of this ASU is permitted. We anticipate that this ASU will impact our financial statements as it relates to the recognition of right-to-use assets and lease obligations on our Consolidated Balance Sheets. We have approximately 50 lease agreements for our branch and loan production offices, which are currently accounted for as operating leases. We expect the new guidance will require these lease agreements to be included on our Consolidated Balance Sheets as right-to-use assets with a corresponding lease liability. We expect that these changes to our Consolidated Balance Sheets will impact our regulatory capital ratios. We have compiled a preliminary inventory of our leases and continue to evaluate the standard. We anticipate that this ASU will impact total assets and total liabilities presented on our Balance Sheets; however, we do not believe that it will materially impact our Consolidated Statements of Comprehensive Income.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

NOTE 2. EARNINGS PER SHARE

The following table reconciles the numerators and denominators of basic and diluted earnings per share for the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except share and per share data)	2018	2017	2018	2017
Numerator for Earnings per Share—Basic:				
Net income	$ 21,436	$ 22,765	$ 47,599	$ 40,953
Less: Income allocated to participating shares	62	81	141	141
Net Income Allocated to Shareholders	$ 21,374	$ 22,684	$ 47,458	$ 40,812
Numerator for Earnings per Share—Diluted:				
Net income	$ 21,436	$ 22,765	$ 47,599	$ 40,953
Net Income Available to Shareholders	$ 21,436	$ 22,765	$ 47,599	$ 40,953
Denominators for Earnings per Share:				
Weighted Average Shares Outstanding—Basic	34,793,160	34,724,925	34,775,043	34,707,683
Add: Potentially dilutive shares	264,416	181,571	267,998	199,693
Denominator for Treasury Stock Method—Diluted	35,057,576	34,906,496	35,043,041	34,907,376
Weighted Average Shares Outstanding—Basic	34,793,160	34,724,925	34,775,043	34,707,683
Add: Average participating shares outstanding	100,212	123,729	103,449	119,585
Denominator for Two-Class Method—Diluted	34,893,372	34,848,654	34,878,492	34,827,268
Earnings per share—basic	$ 0.62	$ 0.66	$ 1.37	$ 1.18
Earnings per share—diluted	$ 0.61	$ 0.65	$ 1.36	$ 1.17
Warrants considered anti-dilutive excluded from potentially dilutive shares - exercise price $31.53 per share, expires January 2019	374,314	466,554	386,747	456,749
Restricted stock considered anti-dilutive excluded from potentially dilutive shares	89,974	126,332	76,325	105,187

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S&T BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

NOTE 3. FAIR VALUE MEASUREMENTS

We use fair value measurements when recording and disclosing certain financial assets and liabilities. Debt securities, equity securities, trading assets and derivative financial instruments are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record other assets at fair value on a nonrecurring basis, such as loans held for sale, impaired loans, other real estate owned, or OREO, and other repossessed assets, mortgage servicing rights, or MSRs, and certain other assets.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants at the measurement date. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction. In determining fair value, we use various valuation approaches, including market, income and cost approaches. The fair value standard establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing an asset or liability, which are developed based on market data that we have obtained from independent sources. Unobservable inputs reflect our estimates of assumptions that market participants would use in pricing an asset or liability, which are developed based on the best information available in the circumstances.

The fair value hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The fair value hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1: valuation is based upon unadjusted quoted market prices for identical instruments traded in active markets.

Level 2: valuation is based upon quoted market prices for similar instruments traded in active markets, quoted market prices for identical or similar instruments traded in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by market data.

Level 3: valuation is derived from other valuation methodologies, including discounted cash flow models and similar techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in determining fair value.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Our policy is to recognize transfers between any of the fair value hierarchy levels at the end of the reporting period in which the transfer occurred.

The following are descriptions of the valuation methodologies that we use for financial instruments recorded at fair value on either a recurring or nonrecurring basis.

Recurring Basis

Debt Securities Available-for-Sale

We obtain fair values for debt securities from a third-party pricing service which utilizes several sources for valuing fixed-income securities. We validate prices received from our pricing service through comparison to a secondary pricing service and broker quotes. We review the methodologies of the pricing service which provide us with a sufficient understanding of the valuation models, assumptions, inputs and pricing to reasonably measure the fair value of our debt securities. The market evaluation sources for debt securities include observable inputs rather than significant unobservable inputs and are classified as Level 2. The service provider utilizes pricing models that vary 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, and extensive quality control programs.

Equity Securities

Marketable equity securities that have an active, quotable market are classified as Level 1. Marketable equity securities that are quotable, but are thinly traded or inactive, are classified as Level 2. Marketable equity securities that are not readily traded and do not have a quotable market are classified as Level 3.

Trading Assets

We use quoted market prices to determine the fair value of our trading assets. Our trading assets are held in a Rabbi Trust under a deferred compensation plan and are invested in readily quoted mutual funds. Accordingly, these assets are classified as Level 1. Rabbi Trust assets are reported in other assets in the Consolidated Balance Sheets.

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NOTE 3. FAIR VALUE MEASUREMENTS – continued

Derivative Financial Instruments

We use derivative instruments, including interest rate swaps for commercial loans with our customers, interest rate lock commitments and the sale of mortgage loans in the secondary market. We calculate the fair value for derivatives using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. Each valuation considers the contractual terms of the derivative, including the period to maturity, and uses observable market-based inputs, such as interest rate curves and implied volatilities. Accordingly, derivatives are classified as Level 2. We incorporate credit valuation adjustments into the valuation models to appropriately reflect both our own nonperformance risk and the respective counterparties' nonperformance risk in calculating fair value measurements. In adjusting the fair value of our derivative contracts for the effect of nonperformance risk, we have considered the impact of netting and any applicable credit enhancements and collateral postings.

Nonrecurring Basis

Loans Held for Sale

Loans held for sale consist of 1-4 family residential loans originated for sale in the secondary market and, from time to time, certain loans transferred from the loan portfolio to loans held for sale, all of which are carried at the lower of cost or fair value. The fair value of 1-4 family residential loans is based on the principal or most advantageous market currently offered for similar loans using observable market data. The fair value of the loans transferred from the loan portfolio is based on the amounts offered for these loans in currently pending sales transactions. Loans held for sale carried at fair value are classified as Level 3.

Impaired Loans

Impaired loans are carried at the lower of carrying value or fair value. Fair value is determined as the recorded investment balance less any specific reserve. We establish specific reserves based on the following three impairment methods: 1) the present value of expected future cash flows discounted at the loan’s original effective interest rate; 2) the loan’s observable market price; or 3) the fair value of the collateral less estimated selling costs when the loan is collateral dependent and we expect to liquidate the collateral. However, if repayment is expected to come from the operation of the collateral, rather than liquidation, then we do not consider estimated selling costs in determining the fair value of the collateral. Collateral values are generally based upon appraisals by approved, independent state certified appraisers. Appraisals may be discounted based on our historical knowledge, changes in market conditions from the time of appraisal or our knowledge of the borrower and the borrower’s business. Impaired loans carried at fair value are classified as Level 3.

OREO and Other Repossessed Assets

OREO and other repossessed assets obtained in partial or total satisfaction of a loan are recorded at the lower of recorded investment in the loan or fair value less cost to sell. Subsequent to foreclosure, these assets are carried at the lower of the amount recorded at acquisition date or fair value less cost to sell. Accordingly, it may be necessary to record nonrecurring fair value adjustments. Fair value, when recorded, is generally based upon appraisals by approved, independent state certified appraisers. Like impaired loans, appraisals on OREO may be discounted based on our historical knowledge, changes in market conditions from the time of appraisal or other information available to us. OREO and other repossessed assets carried at fair value are classified as Level 3.

Mortgage Servicing Rights

The fair value of MSRs is determined by calculating the present value of estimated future net servicing cash flows, considering expected mortgage loan prepayment rates, discount rates, servicing costs and other economic factors, which are determined based on current market conditions. The expected rate of mortgage loan prepayments is the most significant factor driving the value of MSRs. MSRs are considered impaired if the carrying value exceeds fair value. The valuation model includes significant unobservable inputs; therefore, MSRs are classified as Level 3. MSRs are reported in other assets in the Consolidated Balance Sheets and are amortized into noninterest income in the

Consolidated Statements of Comprehensive Income.

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S&T BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

NOTE 3. FAIR VALUE MEASUREMENTS – continued

Other Assets
We measure certain other assets at fair value on a nonrecurring basis. Fair value is based on the application of lower of cost or fair value accounting, or write-downs of individual assets. Valuation methodologies used to measure fair value are consistent with overall principles of fair value accounting and consistent with those described above.
Financial Instruments
In addition to financial instruments recorded at fair value in our financial statements, fair value accounting guidance requires disclosure of the fair value of all of an entity's assets and liabilities that are considered financial instruments. The majority of our assets and liabilities are considered financial instruments. Many of these instruments lack an available trading market as characterized by a willing buyer and a willing seller engaged in an exchange transaction. Also, it is our general practice and intent to hold our financial instruments to maturity and to not engage in trading or sales activities with respect to such financial instruments. For fair value disclosure purposes, we substantially utilize the fair value measurement criteria as required and explained above. In cases where quoted fair values are not available, we use present value methods to determine the fair value of our financial instruments.
Cash and Cash Equivalents
The carrying amounts reported in the Consolidated Balance Sheets for cash and due from banks, including interest-bearing deposits, approximate fair value.
Loans
With the adoption of ASU No. 2016-01, Accounting for Financial Instruments - Overall: Classification and Measurement, on January 1, 2018, we refined our methodology to estimate the fair value of our loan portfolio to use the exit price notion as required by the standard. The guidance was applied on a prospective basis resulting in prior-periods no longer being comparable.
The fair value of variable rate loans that may reprice frequently at short-term market rates is based on carrying values adjusted for liquidity and credit risk. The fair value of variable rate loans that reprice at intervals of one year or longer, such as adjustable rate mortgage products, is estimated using discounted cash flow analyses that utilize interest rates currently being offered for similar loans and adjusted for liquidity and credit risk. The fair value of fixed rate loans is estimated using a discounted cash flow analysis that utilizes interest rates currently being offered for similar loans adjusted for liquidity and credit risk.
Bank Owned Life Insurance
Fair value approximates net cash surrender value of bank owned life insurance, or BOLI.
Federal Home Loan Bank, or FHLB, and Other Restricted Stock
It is not practical to determine the fair value of our FHLB and other restricted stock due to the restrictions placed on the transferability of these stocks; it is presented at carrying value.
Deposits
The fair values disclosed for deposits without defined maturities (e.g., noninterest and interest-bearing demand, money market and savings accounts) are by definition equal to the amounts payable on demand. The carrying amounts for variable rate, fixed-term time deposits approximate their fair values. Estimated fair values for fixed rate and other time deposits are based on discounted cash flow analysis using interest rates currently offered for time deposits with similar terms. The carrying amount of accrued interest approximates fair value.
Short-Term Borrowings
The carrying amounts of securities sold under repurchase agreements, or REPOs, and other short-term borrowings approximate their fair values.

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S&T BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

NOTE 3. FAIR VALUE MEASUREMENTS – continued

Long-Term Borrowings
The fair values disclosed for fixed rate long-term borrowings are determined by discounting their contractual cash flows using current interest rates for long-term borrowings of similar remaining maturities. The carrying amounts of variable rate long-term borrowings approximate their fair values.
Junior Subordinated Debt Securities
The interest rate on the variable rate junior subordinated debt securities is reset quarterly; therefore, the carrying values approximate their fair values.
Loan Commitments and Standby Letters of Credit
Off-balance sheet financial instruments consist of commitments to extend credit and letters of credit. Except for interest rate lock commitments, estimates of the fair value of these off-balance sheet items are not made because of the short-term nature of these arrangements and the credit standing of the counterparties.
Other
Estimates of fair value are not made for items that are not defined as financial instruments, including such items as our core deposit intangibles and the value of our trust operations.
Assets and Liabilities Recorded at Fair Value on a Recurring Basis
The following tables present our assets and liabilities that are measured at fair value on a recurring basis by fair value hierarchy level at June 30, 2018 and December 31, 2017. There were no transfers between Level 1 and Level 2 for items measured at fair value on a recurring basis during the periods presented.

	June 30, 2018			
(dollars in thousands)	Level 1	Level 2	Level 3	Total
ASSETS				
Debt securities available-for-sale:				
U.S. Treasury securities	$—	$9,619	$ —	$9,619
Obligations of U.S. government corporations and agencies	—	155,069	—	155,069
Collateralized mortgage obligations of U.S. government corporations and agencies	—	118,742	—	118,742
Residential mortgage-backed securities of U.S. government corporations and agencies	—	28,442	—	28,442
Commercial mortgage-backed securities of U.S. government corporations and agencies	—	247,128	—	247,128
Obligations of states and political subdivisions	—	123,916	—	123,916
Total Debt Securities Available-for-Sale	—	682,916	—	682,916
Marketable equity securities(1)	—	5,425	—	5,425
Total Securities	—	688,341	—	688,341
Trading securities held in a Rabbi Trust	4,988	—	—	4,988
Derivative financial assets:				
Interest rate swaps	—	6,157	—	6,157
Interest rate lock commitments	—	398	—	398
Total Assets	$4,988	$694,896	$ —	$699,884
LIABILITIES				
Derivative financial liabilities:				
Interest rate swaps	$—	$6,223	$ —	$6,223
Forward sale contracts	—	39	—	39

Total Liabilities	$—	$6,262	$ —	$6,262

[1]ASU No. 2016-01 was adopted January 1, 2018, resulting in separate classification of our marketable equity securities previously included in available-for-sale securities.

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S&T BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

NOTE 3. FAIR VALUE MEASUREMENTS – continued

	December 31, 2017			
(dollars in thousands)	Level 1	Level 2	Level 3	Total
ASSETS				
Debt securities available-for-sale:				
U.S. Treasury securities	$—	$19,789	$ —	$19,789
Obligations of U.S. government corporations and agencies	—	162,193	—	162,193
Collateralized mortgage obligations of U.S. government corporations and agencies	—	108,688	—	108,688
Residential mortgage-backed securities of U.S. government corporations and agencies	—	32,854	—	32,854
Commercial mortgage-backed securities of U.S. government corporations and agencies	—	242,221	—	242,221
Obligations of states and political subdivisions	—	127,402	—	127,402
Total Debt Securities Available-for-Sale	—	693,147	—	693,147
Marketable equity securities	—	5,144	—	5,144
Total Securities	—	698,291	—	698,291
Trading securities held in a Rabbi Trust	5,080	—	—	5,080
Derivative financial assets:				
Interest rate swaps	—	3,074	—	3,074
Interest rate lock commitments	—	226	—	226
Total Assets	$5,080	$701,591	$ —	$706,671
LIABILITIES				
Derivative financial liabilities:				
Interest rate swaps	$—	$3,055	$ —	$3,055
Forward sale contracts	—	5	—	5
Total Liabilities	$—	$3,060	$ —	$3,060

(1)ASU No. 2016-01 was adopted January 1, 2018, resulting in separate classification of our marketable equity securities previously included in available-for-sale securities.

We classify financial instruments as Level 3 when valuation models are used because significant inputs are not observable in the market.

We may be required to measure certain assets and liabilities at fair value on a nonrecurring basis. Nonrecurring assets are recorded at the lower of cost or fair value in our financial statements. There were no liabilities measured at fair value on a nonrecurring basis at either June 30, 2018 or December 31, 2017.

The following table presents our assets that are measured at fair value on a nonrecurring basis by the fair value hierarchy level as of the dates presented: