CSP INC /MA/
Form 10-Q
August 09, 2013

United States
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 June 30, 2013
o	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 0-10843

CSP Inc.
(Exact name of Registrant as specified in its Charter)

Massachusetts	04-2441294
(State of incorporation)	(I.R.S. Employer Identification No.)

43 Manning Road
Billerica, Massachusetts 01821-3901
(978) 663-7598
(Address and telephone number of principal executive offices)

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 o.

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 (§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 o.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of August 7, 2013, the registrant had 3,494,691 shares of common stock issued and outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CSP INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except par value)

	June 30, 2013 (Unaudited)	September 30, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$20,246	$20,493
Accounts receivable, net of allowances of $271 and $243	12,491	12,145
Officer life insurance settlement receivable	—	2,172
Inventories	5,192	6,276
Refundable income taxes	281	121
Deferred income taxes	1,277	1,284
Other current assets	2,737	2,215
Total current assets	42,224	44,706
Property, equipment and improvements, net	1,344	991
Other assets:		
Intangibles, net	431	492
Deferred income taxes	2,655	2,373
Cash surrender value of life insurance	2,451	2,181
Other assets	165	323
Total other assets	5,702	5,369
Total assets	$49,270	$51,066
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$11,670	$13,574
Deferred revenue	4,014	3,693
Pension and retirement plans	699	717
Income taxes payable	49	184
Total current liabilities	16,432	18,168
Pension and retirement plans	9,128	9,431
Other long term liabilities	1,101	426
Total liabilities	26,661	28,025
Commitments and contingencies		
Shareholders' equity:		
Common stock, $.01 par value per share; authorized, 7,500 shares; issued and outstanding 3,495 and 3,399 shares, respectively	34	34
Additional paid-in capital	11,101	10,875
Retained earnings	18,087	18,744
Accumulated other comprehensive loss	(6,613)	(6,612)

Total shareholders’ equity	22,609	23,041
Total liabilities and shareholders’ equity	$49,270	$51,066

See accompanying notes to unaudited consolidated financial statements.

CSP INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in thousands, except for per share data)

	For the three months ended		For the nine months ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Sales:				
Product	$14,783	$16,328	$49,625	$43,607
Services	4,250	6,026	16,101	18,869
Total sales	19,033	22,354	65,726	62,476
Cost of sales:				
Product	12,284	13,899	41,184	37,274
Services	2,914	3,226	10,763	10,435
Total cost of sales	15,198	17,125	51,947	47,709
Gross profit	3,835	5,229	13,779	14,767
Operating expenses:				
Engineering and development	437	444	1,261	1,301
Selling, general and administrative	4,065	3,580	11,790	10,828
Total operating expenses	4,502	4,024	13,051	12,129
Operating income (loss)	(667)	1,205	728	2,638
Other income (expense):				
Foreign exchange gain (loss)	13	(5)	18	(31)
Other income (expense), net	(11)	(27)	18	(71)
Total other income (expense), net	2	(32)	36	(102)
Income (loss) before income taxes	(665)	1,173	764	2,536
Income tax expense (benefit)	(187)	399	387	859
Net income (loss)	$(478)	$774	$377	$1,677
Net income (loss) attributable to common stockholders	$(468)	$759	$369	$1,647
Net income (loss) per share – basic	$(0.14)	$0.23	$0.11	$0.49
Weighted average shares outstanding – basic	3,396	3,366	3,378	3,362
Net income (loss) per share – diluted	$(0.14)	$0.22	$0.11	$0.48
Weighted average shares outstanding – diluted	3,396	3,418	3,432	3,405

See accompanying notes to unaudited consolidated financial statements.

CSP INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Amounts in thousands)

	For the three months ended		For the nine months ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Net income (loss)	$(478)	$774	$377	$1,677
Other comprehensive income (loss):				
Foreign currency translation gain (loss) adjustments	15	(147)	(1)	(216)
Other comprehensive income (loss)	15	(147)	(1)	(216)
Total comprehensive income (loss)	$(463)	$627	$376	$1,461

See accompanying notes to unaudited consolidated financial statements.

CSP INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENT OF SHAREHOLDERS’ EQUITY
For the Nine Months Ended June 30, 2013:
(Amounts in thousands)

	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated other comprehensive loss	Total Shareholders’ Equity
Balance as of September 30, 2012	3,399	$34	$10,875	$18,744	$(6,612)	$23,041
Net income	—	—	—	377	—	377
Other comprehensive loss	—	—	—	—	(1)	(1)
Exercise of stock options	41	—	114	—	—	114
Stock-based compensation	—	—	3	—	—	3
Restricted stock issuance	55	—	109	—	—	109
Cash dividends on common stock ($0.30 per share)	—	—	—	(1,034)	—	(1,034)
Balance as of June 30, 2013	3,495	$34	$11,101	$18,087	$(6,613)	$22,609

See accompanying notes to unaudited consolidated financial statements.

CSP INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)

	For the nine months ended	
	June 30, 2013	June 30, 2012
Cash flows from operating activities:		
Net income	$377	$1,677
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	324	278
Amortization of intangibles	62	62
Gain on sale of fixed assets, net	(17)	—
Foreign exchange (gain) loss	(18)	31
Non-cash changes in accounts receivable	27	(120)
Stock-based compensation expense on stock options and restricted stock awards	112	99
Deferred income taxes	334	84
Increase in cash surrender value of life insurance	(73)	(69)
Changes in operating assets and liabilities:		
Increase in accounts receivable	(354)	(1,213)
Decrease in officer life insurance receivable	2,172	—
Decrease in inventories	1,060	383
(Increase) decrease in refundable income taxes	(158)	36
Increase in other current assets	(276)	(1,550)
(Increase) decrease in other assets	(81)	17
Increase (decrease) in accounts payable and accrued expenses	(1,955)	2,650
Increase in deferred revenue	307	909
Decrease in pension and retirement plans liability	(175)	(80)
Increase (decrease) in income taxes payable	(136)	105
Increase in other long term liabilities	73	132
Net cash provided by operating activities	1,605	3,431
Cash flows from investing activities:		
Life insurance premiums paid	(198)	(140)
Proceeds from the sale of fixed assets	17	—
Purchases of property, equipment and improvements	(675)	(373)
Net cash used in investing activities	(856)	(513)
Cash flows from financing activities:		
Dividends paid	(1,034)	(342)
Proceeds from issuance of shares from exercise of employee stock options	114	—
Purchase of common stock	—	(96)
Net cash used in financing activities	(920)	(438)
Effects of exchange rate on cash	(76)	(317)
Net increase (decrease) in cash and cash equivalents	(247)	2,163
Cash and cash equivalents, beginning of period	20,493	15,874
Cash and cash equivalents, end of period	$20,246	$18,037
Supplementary cash flow information:		
Cash paid for income taxes	$383	$613
Cash paid for interest	$85	$85

See accompanying notes to unaudited consolidated financial statements.

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CSP INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
THREE AND NINE MONTHS ENDED JUNE 30, 2013 AND 2012

Organization and Business

CSP Inc. was founded in 1968 and is based in Billerica, Massachusetts. To meet the diverse requirements of its industrial, commercial and defense customers worldwide, CSP Inc. and its subsidiaries (collectively “CSPI” or the “Company”) develop and market IT integration solutions and high-performance cluster computer systems. The Company operates in two segments, its Systems segment and its Service and System Integration segment.

1. Basis of Presentation

The accompanying consolidated financial statements have been prepared by the Company, without audit, and reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the results of the interim periods presented. All adjustments were of a normal recurring nature. Certain information and footnote disclosures normally included in the annual financial statements, which are prepared in accordance with accounting principles generally accepted in the United States, have been condensed or omitted. Accordingly, the Company believes that although the disclosures are adequate to make the information presented not misleading, the unaudited financial statements should be read in conjunction with the footnotes contained in the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

2. Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates under different assumptions or conditions.

3. Earnings Per Share of Common Stock

Basic net income per common share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted net income per common share reflects the maximum dilution that would have resulted from the assumed exercise and share repurchase related to dilutive stock options and is computed by dividing net income by the assumed weighted average number of common shares outstanding.

We are required to present earnings per share, or EPS, utilizing the two class method because we had outstanding, non-vested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents, which are considered participating securities.

Basic and diluted earnings per share computations for the Company’s reported net income attributable to common stockholders are as follows:

	For the three months ended		For the nine months ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
	(Amounts in thousands except per share data)			
Net income (loss)	$(478)	$774	$377	$1,677
Less: Net income (loss) attributable to nonvested common stock	(10)	15	8	30
Net income (loss) attributable to common stockholders	$(468)	$759	$369	$1,647
Weighted average total shares outstanding – basic	3,468	3,433	3,447	3,422
Less: weighted average non-vested shares outstanding	72	67	69	60
Weighted average number of common shares outstanding – basic	3,396	3,366	3,378	3,362
Potential common shares from non-vested stock awards and the assumed exercise of stock options	—	52	54	43
Weighted average common shares outstanding – diluted	3,396	3,418	3,432	3,405
Net income (loss) per share – basic	$(0.14)	$0.23	$0.11	$0.49
Net income (loss) per share – diluted	$(0.14)	$0.22	$0.11	$0.48

All anti-dilutive securities, including certain stock options, are excluded from the diluted income per share computation. For the three months ended June 30, 2013 and 2012, 173,000 and 195,000 options, respectively, were excluded from the diluted income per share calculation because their inclusion would have been anti-dilutive. For the nine months ended June 30, 2013 and 2012, 162,000 and 198,000 options, respectively, were excluded from the diluted income per share calculation because their inclusion would have been anti-dilutive.

4. Inventories

Inventories consist of the following:

	June 30, 2013	September 30, 2012
	(Amounts in thousands)	
Raw materials	$1,217	$941
Work-in-process	669	1,407
Finished goods	3,306	3,928
Total	$5,192	$6,276

Finished goods includes inventory that has been shipped, but for which all revenue recognition criteria has not been met, of approximately $1.1 million and $1.4 million as of June 30, 2013 and September 30, 2012, respectively.

Total inventory balances in the table above are shown net of reserves for obsolescence of approximately $4.5 million and $4.4 million as of June 30, 2013 and September 30, 2012, respectively.

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5. Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

	June 30, 2013	September 30, 2012
	(Amounts in thousands)	
Cumulative effect of foreign currency translation	$(2,274)	$(2,273)
Additional minimum pension liability	(4,339)	(4,339)
Accumulated other comprehensive loss	$(6,613)	$(6,612)

6. Pension and Retirement Plans

The Company has defined benefit and defined contribution plans in the United Kingdom, Germany and the U.S. In the United Kingdom and Germany, the Company provides defined benefit pension plans and defined contribution plans for the majority of its employees. In the U.S., the Company provides benefits through supplemental retirement plans to certain current and former employees. The domestic supplemental retirement plans have life insurance policies which are not plan assets but were purchased by the Company as a vehicle to fund the costs of the plan. Domestically, the Company also provides for officer death benefits through post-retirement plans to certain officers. All of the Company’s defined benefit plans are closed to newly hired employees and have been for the two years ended September 30, 2012 and for the nine months ended June 30, 2013.

The Company funds its pension plans in amounts sufficient to meet the requirements set forth in applicable employee benefits laws and local tax laws. Liabilities for amounts in excess of these funding levels are accrued and reported in the consolidated balance sheets.

Our pension plan in the United Kingdom is the only plan with plan assets. The plan assets consist of an investment in a commingled fund which in turn comprises a diversified mix of assets including corporate equity securities, government securities and corporate debt securities.

The components of net periodic benefit costs related to the U.S. and international plans are as follows:

	For the Three Months Ended June 30,					
	2013			2012		
	Foreign	U.S.	Total	Foreign	U.S.	Total
	(Amounts in thousands)					
Pension:						
Service cost	$15	$—	$15	$15	$3	$18
Interest cost	163	16	179	178	20	198
Expected return on plan assets	(96)	—	(96)	(105)	—	(105)
Amortization of:						
Prior service gain	—	—	—	—	—	—
Amortization of net gain	35	6	41	22	8	30
Net periodic benefit cost	$117	$22	$139	$110	$31	$141
Post Retirement:						
Service cost	$—	$—	$—	$—	$—	$—
Interest cost	—	8	8	—	18	18
Amortization of net gain	—	(44)	(44)	—	17	17
Net periodic benefit cost	$—	$(36)	$(36)	$—	$35	$35

	For the Nine Months Ended June 30,					
	2013			2012		
	Foreign	U.S.	Total	Foreign	U.S.	Total
	(Amounts in thousands)					
Pension:						
Service cost	$45	$—	$45	$47	$8	$55
Interest cost	509	48	557	534	62	596
Expected return on plan assets	(304)	—	(304)	(313)	—	(313)
Amortization of:						
Prior service gain	—	—	—	—	—	—
Amortization of net gain	107	18	125	66	23	89
Net periodic benefit cost	$357	$66	$423	$334	$93	$427
Post Retirement:						
Service cost	$—	$—	$—	$—	$—	$—
Interest cost	—	26	26	—	53	53
Amortization of net gain	—	(136)	(136)	—	53	53
Net periodic benefit cost	$—	$(110)	$(110)	$—	$106	$106

7. Segment Information

The following table presents certain operating segment information.

Service and System Integration Segment

ForONT FACE="Times New Roman" SIZE="2"> **45.1** **6.17%**

Noninterest-earning assets	215.2			193.3		
Total	**$ 3,285.8**			**$ 3,090.5**		
Liabilities And Shareholders Equity						
NOW/money market/savings	$ 1,203.7	10.1	3.34%	$ 955.2	$ 4.1	1.70%
Time deposits	880.1	9.1	4.12%	900.2	7.7	3.38%
Borrowed funds < 1 year	190.8	2.5	5.08%	338.8	2.8	3.35%
Borrowed funds > 1 year	185.5	2.5	5.30%	82.2	1.0	4.68%
Total interest-bearing liabilities	**2,460.1**	**24.2**	**3.90%**	**2,276.4**	**15.6**	**2.72%**
Noninterest-bearing liabilities:						
Demand deposits	435.0			413.7		
Shareholders equity/Other	390.7			400.4		
Total	**$ 3,285.8**			**$ 3,090.5**		
Net yield on interest-earning assets			**3.87%**			**4.03%**
Net interest income		**$ 30.0**			**$ 29.5**	

(1) The yield on earning assets and the net interest margin are presented on a fully taxable-equivalent (FTE) and annualized basis. The FTE basis adjusts for the tax benefit of income on certain tax-exempt loans and investments using the federal statutory tax rate of 35 percent for each period presented. S&T believes this measure to be the preferred industry measurement of net interest income and provides relevant comparison between taxable and non-taxable amounts.

The following table sets forth for the periods indicated a summary of the changes in interest earned and interest paid resulting from changes in volume and changes in rates:

	Three Months Ended September 30, 2006 Compared to September 30, 2005 Increase (Decrease) Due to (1)		
(dollars in thousands)	**Volume**	**Rate**	**Net**
Interest earned on:			
Loans*(2)*	$ 3,872	$ 5,747	$ 9,619
Securities/Other*(2)*	(699)	195	(504)
Total interest-earning assets	**3,173**	**5,942**	**9,115**
Interest paid on:			
NOW/money market/savings	$ 1,067	$ 4,959	$ 6,026
Time deposits	(171)	1,644	1,473
Borrowed funds < 1 year	(1,249)	833	(416)
Borrowed funds > 1 year	1,219	289	1,508
Total interest-bearing liabilities	**866**	**7,725**	**8,591**
Change in net interest income	**$ 2,307**	**$ (1,783)**	**$ 524**

(1)

The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

(2) Tax-exempt income is on a fully tax-equivalent basis using the statutory federal corporate income tax rate of 35 percent for 2006 and 2005.

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S&T BANCORP, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

Provision for Loan Losses

The provision for loan losses was $1.4 million for the third quarter of 2006 and $3.0 million for the third quarter of 2005. The provision is the result of management s assessment of credit quality statistics and other factors that would have an impact on probable losses in the loan portfolio and the model used to determine the adequacy of the allowance for loan losses. Changes in the risk ratings within the allowance for loan loss model are consistent with the decline in asset quality which includes a significant increase in net charge-offs and nonperforming loans that occurred as a result of the aforementioned commercial loan relationships.

Credit quality is the most important factor in determining the amount of the allowance for loan losses and the resulting provision. Also affecting the amount of the allowance for loan losses, and resulting provision is loan growth and portfolio composition. Most of the loan growth during the third quarter of 2006 and 2005 is attributable to larger-sized commercial loans. Net charged-off loans were $7.2 million and $0.4 million for the third quarter of 2006 and 2005, respectively. The most significant charge-off for the third quarter of 2006 was the aforementioned commercial construction company, previously classified as nonaccrual and was assigned a specific reserve of $7.1 million as of June 30, 2006, was charged-down by $7.2 million during the third quarter of 2006 and was previously considered in the analysis for the adequacy of the allowance for loan losses.

Noninterest Income

Noninterest income, excluding security gains, increased $0.6 million or 7 percent in the third quarter of 2006 as compared to 2005. Increases included $0.2 million or 7 percent in service charges on deposit accounts, $0.1 million or 5 percent in wealth management fees, and $0.3 million or 26 percent in insurance commissions. The increase in service charges on deposit accounts is primarily a result of management s continued effort to implement reasonable fees for services performed and to manage closely the collection of these fees, as well as to expand new cash management relationships. Changes in pricing and processes for assessing fees for insufficient funds resulted in a $0.3 million increase during the third quarter of 2006 as compared to the same period of 2005. The increase in wealth management fees is primarily attributable to new business development, offset by a decline in market values of customer accounts during the third quarter of 2006. The increase of $0.4 million in insurance commissions is attributable to stronger overall sales volume and the acquisition of the Holsinger Insurance Agency during the first quarter of 2006, as well as higher volumes from consumer loan payment protection insurance during 2006.

S&T recognized $1.2 million of net gains on available for sale securities in the third quarter of 2006 as compared to $1.3 million in the same period of 2005. Included in the investment security gains for the third of 2006 is a $0.2 million of unrealized losses taken for an other-than-temporary impairment on one equity investment security.

Noninterest Expense

Noninterest expense increased $1.7 million or 11 percent in the third quarter of 2006 as compared to the third quarter of 2005. Salaries and employee benefit expense decreased $0.1 million or 2 percent primarily attributable to lower accrual levels for 2006 performance incentive payouts, offset by the effects of normal merit increases, the addition of 14 average quarterly full-time equivalent staff to implement new strategic initiatives and to staff new retail facilities, $0.1 million in higher medical expenses and $0.2 million in compensation expense as a result of applying the provisions of SFAS No. 123 (R). Average quarterly full-time equivalent staff was 807 at September 30, 2006 compared to 793 at September 30, 2005. Furniture and equipment expense increased $0.3 million or 16 percent primarily a result of additional expenses related to the new corporate headquarters, which opened in the third quarter of 2006. Data processing expense increased $0.1 million or 13 percent as compared to the same period in 2005 due to new and expanded product offerings. The increase of $1.4 million or 35 percent in other noninterest expense during the third quarter of 2006 is primarily attributable to the $0.2 million net charge-down of properties acquired through foreclosure to current market and property conditions, $0.4 million or revenue received in third quarter 2005 for a historical rehabilitation tax credit partnership, $0.1 million increase in legal expense, a $0.1 million sales and use tax refund received in the third quarter of 2005 and a $0.2 million increase in the reserve for unfunded loan commitments.

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S&T BANCORP, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF

OPERATIONS continued

Federal Income Taxes

Federal income tax expense increased $0.6 million in the third quarter of 2006 as compared to the third quarter of 2005. The effective tax rate for the third quarter of 2006 and 2005 was 30 percent and 29 percent, respectively, which is below the 35 percent statutory rate due primarily to benefits resulting from tax-exempt interest, excludable dividend income and the tax benefits associated with Low Income Housing Tax Credit (LIHTC) and Federal Historic Tax Credit projects.

Critical Accounting Policies and Judgments

S&T s consolidated financial statements are prepared based upon the application of certain critical accounting policies affecting accounts such as: investment securities, allowance for loan losses, mortgage servicing rights valuations and goodwill and other intangibles. Certain of these policies require numerous estimates and strategic or economic assumptions that may prove inaccurate or subject to variations and may significantly affect S&T s reported results and financial position for the period or in future periods. Changes in underlying factors, assumptions or estimates in any of these areas could have a material impact on S&T s future financial condition and results of operations. S&T s critical accounting policies are presented in Management s Discussion and Analysis of Financial Condition and Results of Operations in S&T s Annual Report on Form 10-K, filed with the SEC on March 1, 2006. There have been no material changes in S&T s critical accounting policies since December 31, 2005.

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995

This Quarterly Report on Form 10-Q contains or incorporates statements that we believe are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. They usually can be identified by the use of forward-looking language such as will likely result, may, are expected to, is anticipated, estimate, forecast, projected, intends to or other similar words. You should not place undue reliance on these statements, as they are subject to risks and uncertainties, including but not limited to those described in this Form 10-Q or the documents incorporated by reference. When considering these forward-looking statements, you should keep in mind these risks and uncertainties, as well as any cautionary statements we may make. Moreover, you should treat these statements as speaking only as of the date they are made and based only on information then actually known to us. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

These forward-looking statements are based on current expectations, estimates and projections about S&T s business, management s beliefs and assumptions made by management. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions (Future Factors), which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in these forward-looking statements.

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S&T BANCORP, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS continued

Future Factors include:

- changes in interest rates, spreads on earning assets and interest-bearing liabilities, and interest rate sensitivity;
- credit losses;
- sources of liquidity;
- legislation affecting the financial services industry as a whole, and/or S&T and its subsidiaries individually or collectively;
- regulatory supervision and oversight, including required capital levels;
- increasing price and product/service competition by competitors, including new entrants;
- rapid technological developments and changes;
- the ability to continue to introduce competitive new products and services on a timely, cost-effective basis;
- the mix of products/services;
- containing costs and expenses;
- governmental and public policy changes, including environmental regulations;
- reliance on large customers;
- technological, implementation and cost/financial risks in large, multi-year contracts;

the outcome of pending and future litigation and governmental proceedings;

continued availability of financing;

financial resources in the amounts, at the times and on the terms required to support our future businesses; and

general economic or business conditions, either nationally or regionally, may be less favorable than expected, resulting in among other things, a reduced demand for credit and other services.

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Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ALCO monitors and manages interest-rate sensitivity through gap, rate shock analysis and simulations in order to avoid unacceptable earnings fluctuations due to interest rate changes. S&T s gap model includes certain management assumptions based upon past experience and the expected behavior of customers. The assumptions include principal prepayments for fixed rate loans, mortgage-backed securities and collateralized mortgage obligations (CMOs), and classifying the demand, savings and money market balances by degree of interest-rate sensitivity.

The gap and cumulative gap represent the net position of assets and liabilities subject to repricing in specified time periods, as measured by a ratio of rate sensitive assets to rate sensitive liabilities. The table below shows the amount and timing of repricing assets and liabilities as of September 30, 2006.

	Interest Rate Sensitivity September 30, 2006 (dollars in thousands)			
GAP	**1-6 Months**	**7-12 Months**	**13-24 Months**	**>2 Years**
Repricing Assets:				
Cash/Due From Banks	$	$	$	$ 58,938
Securities	31,704	35,502	69,032	295,252
Net Loans	1,301,477	225,545	368,798	688,717
Other Assets				203,745
Total	1,333,181	261,047	437,830	1,246,652
Repricing Liabilities:				
Demand				429,547
NOW	18,424	18,424	36,848	73,697
Money Market	168,587			
Savings/Clubs	770,940	16,333	32,667	65,333
Certificates	356,702	268,577	169,547	110,466
Repos & Short-term Borrowings	162,351			
Long-term Borrowings	3,528	10,439	50,908	121,342
Other Liabilities/Equity				394,050
Total	1,480,532	313,773	289,970	1,194,435
Gap	**(147,351)**	**(52,726)**	**147,860**	**52,217**
Cumulative GAP	**$ (147,351)**	**$ (200,077)**	**$ (52,217)**	**$**

Rate Sensitive Assets/Rate Sensitive Liabilities	**September 30, 2006**	**December 31, 2005**
Cumulative 6 months	0.90%	0.96%
Cumulative 12 months	0.89%	0.96%

S&T s one-year gap position at September 30, 2006 indicates a liability sensitive position. This means that more liabilities than assets will reprice during the measured time frames. The implications of a liability sensitive position will differ depending upon the change in market interest rates.

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Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK continued

For example, with a liability sensitive position in a declining interest rate environment, more liabilities than assets will decrease in rate. This situation could result in an increase to our interest rate spreads, net interest income and operating spreads. Conversely, with a liability sensitive position in a rising interest rate environment, more liabilities than assets will increase in rate. This situation could result in a decrease to our interest rate spreads, net interest income and operating spreads. S&T has become more liability sensitive since December 31, 2005, primarily due to growth in indexed savings balances and a decrease in variable rate loans as commercial borrowers have shifted their preference to longer term fixed rates during this period of a flat and an inverted yield curve.

In addition to the gap analysis, S&T performs rate shock analyses on a static balance sheet to estimate the effect that specific interest-rate changes would have on 12 months of pretax net interest income. The rate shock incorporates management assumptions regarding the level of interest rate changes on non-maturity deposit products (savings, money market, NOW and demand deposits) and changes in the prepayment behavior of fixed rate loans and securities with optionality. Inclusion of these assumptions makes rate shock analysis more useful than gap analysis alone. The table below shows the results of the rate shock analyses.

Change in Pretax net interest income	**Immediate Change in Rates**	
(dollars in millions)	**+300 bps**	**-300 bps**
September 30, 2006	$ (4.7)	$ (2.5)
December 31, 2005	$ (1.0)	$ (5.9)

The results in the 300 basis point shock scenario are not consistent with a liability sensitive gap position, which would indicate an increase in net interest income. This is primarily due to: (1) rates on regular savings, NOW and money market accounts have lagged as short rates have increased and cannot be decreased to any great extent should rates go down; and (2) loan refinance activity will be considerable in a rates down interest rate scenario. The improvement in the 300 basis point results when compared to December 2005 can be attributed to two main reasons: (1) strong growth in indexed savings balances and; (2) implementing a strategy to mitigate the rates down risk on the balance sheet through structured borrowings.

Consistent with a liability sensitive gap position, the +300 rate shock results show pretax net interest income decreasing in an increasing interest rate environment. The decline in the +300 basis point results from December 2005 is primarily due to strong growth in indexed savings balances.

Item 4. CONTROLS AND PROCEDURES

The Chief Executive Officer and Chief Financial Officer conducted an evaluation of the effectiveness of the design and operation of S&T s disclosure controls and procedures as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that S&T s disclosure controls and procedures were effective as of the end of the period covered by this report. There were no significant changes in internal controls over financial reporting that occurred during the third quarter of 2006 that have materially affected, or are reasonably likely to materially affect, S&T s internal control over financial reporting.

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PART II

OTHER INFORMATION

Item 1. Legal Proceedings.

Not Applicable

Item 1A. Risk Factors.

Risk factors are presented at December 31, 2005 in Item 1A of S&T s Annual Report on Form 10-K, filed with the SEC on March 1, 2006. Management believes that there have been no material changes in S&T s risk factors since December 31, 2005.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The following information describes the activity that has taken place during 2006 with respect to S&T s share repurchase plan:

Period	**Total Number of Shares Purchased**	**Average Price Paid per Share**	**Total Number of Shares Purchased as part of Publicly Announced Plans**	**Maximum Number of Shares that can be Purchased Under the Plan**
January 1, 2006 January 31, 2006*(1)(2)(3)*	40,000	$ 36.30	40,000	
February 1, 2006 February 28, 2006	33,000	36.13	33,000	
March 1, 2006 March 31, 2006	131,000	35.88	131,000	
April 1, 2006 April 30, 2006	175,000	35.43	175,000	
May 1, 2006 May 31, 2006	225,000	35.11	225,000	
June 1, 2006 June 30, 2006				
July 1, 2006 July 31, 2006	100,000	31.72	100,000	
August 1, 2006 August 31, 2006				
September 1, 2006 September 30, 2006	295,000	32.38	295,000	
Total	**999,000**	**$ 34.20**	**999,000**	**1,000,000**

(1) The plan was announced on December 20, 2005.

(2) The plan was approved by the S&T Board of Directors for the repurchase of up to 1,000,000 shares.

(3) The expiration date of the previous plan was December 31, 2006. On October 16, 2006 the S&T Board of Directors authorized and announced a new stock buyback program until September 30, 2007 for an additional one million shares.

Item 3. Defaults Upon Senior Securities.

Not Applicable

Item 4. Submission of Matters to a Vote of Security Holders.

Not Applicable

Item 5. Other Information.

Not Applicable

Item 6. Exhibits

The following exhibits are filed herewith.

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OTHER INFORMATION continued

Exhibit 31.1

Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.

Exhibit 31.2

Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.

Exhibit 32

Certification for James C. Miller, Chief Executive Officer, and Robert E. Rout, Chief Financial Officer, pursuant to Rule 13a-14(b) and Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

S&T Bancorp, Inc.

(Registrant)

Date: November 7, 2006

/s/ Robert E. Rout
Robert E. Rout

Senior Executive Vice President, Chief Financial Officer and Secretary