FIRST MID ILLINOIS BANCSHARES INC
Form 10-Q
May 08, 2008

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 March 31, 2008

Or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____________ to ______________

Commission file number 0-13368

FIRST MID-ILLINOIS BANCSHARES, INC.
(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	37-1103704 (I.R.S. employer identification no.)
1515 Charleston Avenue, Mattoon, Illinois (Address of principal executive offices)	61938 (Zip code)

(217) 234-7454
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, 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 [ ]	Accelerated filer [X]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	Smaller reporting company [ ]

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). [ ] Yes [X] No

As of May 7, 2008, 6,238,271 common shares, $4.00 par value, were outstanding.

PART I

ITEM 1. FINANCIAL STATEMENTS

Condensed Consolidated Balance Sheets

(In thousands, except share data)	(Unaudited) March 31, 2008	December 31, 2007
Assets		
Cash and due from banks:		
Non-interest bearing	$ 22,808	$ 28,737
Interest bearing	23,617	136
Federal funds sold	18,288	2,250
Cash and cash equivalents	64,713	31,123
Investment securities:		
Available-for-sale, at fair value	169,783	184,033
Held-to-maturity, at amortized cost (estimated fair value of $1,062 and $1,194 at March 31, 2008 and December 31, 2007, respectively)	1,043	1,178
Loans held for sale	3,612	1,974
Loans	734,229	746,187
Less allowance for loan losses	(6,251)	(6,118)
Net loans	727,978	740,069
Interest receivable	6,582	8,309
Premises and equipment, net	15,210	15,520
Goodwill, net	17,363	17,363
Intangible assets, net	4,136	4,327
Other assets	10,740	12,442
Total assets	$ 1,021,160	$ 1,016,338
Liabilities and Stockholders' Equity		
Deposits:		
Non-interest bearing	$ 120,775	$ 124,486
Interest bearing	674,932	646,097
Total deposits	795,707	770,583
Securities sold under agreements to repurchase	54,251	68,300
Interest payable	2,604	2,264
Other borrowings	59,250	67,250
Junior subordinated debentures	20,620	20,620
Other liabilities	5,532	6,869
Total liabilities	937,964	935,886
Stockholders' Equity		
Common stock, $4 par value; authorized 18,000,000 shares; issued 7,163,687 shares in 2008 and 7,135,113 shares in 2007	28,655	28,540
Additional paid-in capital	23,941	23,308
Retained earnings	52,817	49,895
Deferred compensation	2,629	2,568
Accumulated other comprehensive income	1,815	1,096
Less treasury stock at cost, 923,385 shares in 2008 and 858,396 shares in 2007	(26,661)	(24,955)
Total stockholders' equity	83,196	80,452
Total liabilities and stockholders' equity	$ 1,021,160	$ 1,016,338

See accompanying notes to unaudited condensed consolidated financial statements.

Condensed Consolidated Statements of Income (unaudited)
(In thousands, except per share data)

	Three months ended March 31, 2008	Three months ended March 31, 2007
Interest income:		
Interest and fees on loans	$ 12,354	$ 12,172
Interest on investment securities	2,122	2,269
Interest on federal funds sold	158	81
Interest on deposits with other financial institutions	153	4
Total interest income	14,787	14,526
Interest expense:		
Interest on deposits	4,850	5,290
Interest on securities sold under agreements to repurchase	368	577
Interest on other borrowings	701	587
Interest on subordinated debentures	366	395
Total interest expense	6,285	6,849
Net interest income	8,502	7,677
Provision for loan losses	191	186
Net interest income after provision for loan losses	8,311	7,491
Other income:		
Trust revenues	744	717
Brokerage commissions	99	112
Insurance commissions	709	699
Service charges	1,321	1,270
Securities gains, net	151	139
Mortgage banking revenue, net	108	121
Other	838	774
Total other income	3,970	3,832
Other expense:		
Salaries and employee benefits	4,124	4,076
Net occupancy and equipment expense	1,235	1,217
Amortization of intangible assets	191	217
Stationery and supplies	143	145
Legal and professional	479	474
Marketing and promotion	176	206
Other	1,437	1,196
Total other expense	7,785	7,531
Income before income taxes	4,496	3,792
Income taxes	1,574	1,198
Net income	$ 2,922	$ 2,594
Per share data:		
Basic earnings per share	$ 0.47	$ 0.40
Diluted earnings per share	$ 0.46	$ 0.40
Cash dividends per share	$ -	$ -

See accompanying notes to unaudited condensed consolidated financial statements.

Condensed Consolidated Statements of Cash Flows (unaudited) (In thousands)	Three months ended March 31, 2008	 2007
Cash flows from operating activities:		
Net income	$ 2,922	$ 2,594
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	191	186
Depreciation, amortization and accretion, net	516	450
Stock-based compensation expense	16	8
Gains on sale of securities, net	(151)	(139)
(Gains) losses on sale of other real property owned, net	44	(19)
Loss on write down of fixed assets	132	-
Gains on sale of loans held for sale, net	(121)	(130)
Origination of loans held for sale	(12,134)	(11,556)
Proceeds from sale of loans held for sale	10,617	12,616
Decrease in other assets	2,662	1,211
Increase (decrease) in other liabilities	197	(715)
Net cash provided by operating activities	4,891	4,506
Cash flows from investing activities:		
Proceeds from sales of securities available-for-sale	-	7,567
Proceeds from maturities of securities available-for-sale	56,914	11,738
Proceeds from maturities of securities held-to-maturity	135	125
Purchases of securities available-for-sale	(41,263)	(12,572)
Net decrease in loans	11,900	13,434
Purchases of premises and equipment	(85)	(158)
Proceeds from sales of other real property owned	186	152
Net cash provided by investing activities	27,787	20,286
Cash flows from financing activities:		
Net increase in deposits	25,124	7,657
Decrease in federal funds purchased	-	(6,800)
Decrease in repurchase agreements	(14,049)	(18,393)
Proceeds from short term FHLB advances	-	7,000
Repayment of short term FHLB advances	(10,000)	(7,000)
Proceeds from long term FHLB advances	-	10,000
Proceeds from long term debt	2,000	4,000
Repayment of long term debt	-	(500)
Proceeds from issuance of common stock	262	444
Purchase of treasury stock	(1,646)	(3,008)
Dividends paid on common stock	(779)	(732)
Net cash provided by (used in) financing activities	912	(7,332)
Increase in cash and cash equivalents	33,590	17,460
Cash and cash equivalents at beginning of period	31,123	21,836
Cash and cash equivalents at end of period	$ 64,713	$ 39,296

Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	$ 5,945	$ 6,732
Income taxes	450	232
Supplemental disclosures of noncash investing and financing activities		
Loans transferred to real estate owned	135	18
Dividends reinvested in common stock	414	383
Net tax benefit related to option and deferred compensation plans	55	166

See accompanying notes to unaudited condensed consolidated financial statements.

Notes to Consolidated Financial Statements
(unaudited)

Basis of Accounting and Consolidation

The unaudited condensed consolidated financial statements include the accounts of First Mid-Illinois Bancshares, Inc. (“Company”) and the following wholly-owned subsidiaries: Mid-Illinois Data Services, Inc. (“MIDS”), The Checkley Agency, Inc. (“Checkley”), and First Mid-Illinois Bank & Trust, N.A. (“First Mid Bank”). All significant intercompany balances and transactions have been eliminated in consolidation. The financial information reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods ended March 31, 2008 and 2007, and all such adjustments are of a normal recurring nature. Certain amounts in the prior year’s consolidated financial statements have been reclassified to conform to the March 31, 2008 presentation and there was no impact on net income or stockholders’ equity. The results of the interim period ended March 31, 2008 are not necessarily indicative of the results expected for the year ending December 31, 2008. The Company operates as a one-segment entity for financial reporting purposes.

The 2007 year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles.

The unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information required by U.S. generally accepted accounting principles for complete financial statements and related footnote disclosures although the Company believes that the disclosures made are adequate to make the information not misleading. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s 2007 Annual Report on Form 10-K.

Stock Plans

At the Annual Meeting of Stockholders held May 23, 2007, the stockholders approved the First Mid-Illinois Bancshares, Inc. 2007 Stock Incentive Plan (“SI Plan”). The SI Plan was implemented to succeed the Company’s 1997 Stock Incentive Plan, which had a ten-year term that expired October 21, 2007. The SI Plan is intended to provide a means whereby directors, employees, consultants and advisors of the Company and its subsidiaries may sustain a sense of proprietorship and personal involvement in the continued development and financial success of the Company and its subsidiaries, thereby advancing the interests of the Company and its stockholders. Accordingly, directors and selected employees, consultants and advisors may be provided the opportunity to acquire shares of common stock of the Company on the terms and conditions established herein in the SI Plan.

A maximum of 300,000 shares of common stock may be issued under the SI Plan. As of December 31, 2007, the Company had awarded 32,000 shares under the plan. There were no shares awarded during the first quarter of 2008.

Stock Split

On June 29, 2007, the Company effected a three-for-two stock split in the form of a 50% stock dividend for all shareholders of record as of June 18, 2007. Accordingly, an entry was made for $9,493,000 to increase the common stock account and decrease the retained earnings account. Par value remained at $4 per share. All current and prior period share and per share amounts have been restated giving retroactive recognition to the stock split.

Treasury Stock

On May 23, 2007, the Company retired 1,500,000 shares of its treasury stock (after adjustment for stock split), the cost of which was determined using the first-in, first-out method. Accordingly, an entry was made to decrease the treasury stock account for $21,021,000, the common stock account for $4,000,000 and the retained earnings account for $17,021,000.

Website

The Company maintains a website at www.firstmid.com. All periodic and current reports of the Company and amendments to these reports filed with the Securities and Exchange Commission ("SEC") can be accessed, free of charge, through this website as soon as reasonably practicable after these materials are filed with the SEC.

Comprehensive Income

The Company's comprehensive income for the three-month periods ended March 31, 2008 and 2007 was as follows (in thousands):

	Three months ended March 31, 2008	2007
Net income	$ 2,922	$ 2,594
Other comprehensive income:		
Unrealized gains during the period	1,330	300
Less realized gains during the period	(151)	(139)
Tax effect	(460)	(62)
Total other comprehensive income	719	99
Comprehensive income	$ 3,641	$ 2,693

New Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 161 (FAS 161), "Disclosures About Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133." FAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. FAS 161 is effective for fiscal years beginning after November 15, 2008. The Company does not expect the implementation of FAS 161 to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160 (FAS 160), "Noncontrolling Interests in Consolidated Financial Statements -- an amendment of ARB No.51." FAS 160 requires that a noncontrolling interest in a subsidiary be reported separately within equity and the amount of consolidated net income specifically attributable to the noncontrolling interest be identified in the consolidated financial statements. It also calls for consistency in the manner of reporting changes in the parent's ownership interest and requires fair value measurement of any noncontrolling equity investment retained in deconsolidation. FAS 160 is effective for fiscal years beginning after December 15, 2008. The Company does not expect the implementation of FAS 160 to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R) (FAS 141(R)), "Business Combinations." FAS 141(R) will significantly change the financial accounting and reporting of business combination transactions. FAS 141(R) establishes principles for how an acquirer recognizes and measures the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree; recognizes and measures goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. FAS 141(R) is effective for acquisition dates in fiscal years beginning after December 15, 2008. The Company does not expect the implementation of FAS 141(R) to have a material impact on its consolidated financial statements.

Earnings Per Share

A three-for-two common stock split was effected on June 29, 2007, in the form of a 50% stock dividend for the stockholders of record at the close of business on June 18, 2007. Accordingly, information with respect to shares of common stock and earnings per share has been restated for current and prior periods presented to fully reflect the stock split. Basic earnings per share ("EPS") is calculated as net income divided by the weighted average number of common shares outstanding. Diluted EPS is computed using the weighted average number of common shares outstanding, increased by the assumed conversion of the Company's stock options, unless anti-dilutive.

The components of basic and diluted earnings per common share for the three-month periods ended March 31, 2008 and 2007 were as follows:

	Three months ended March 31, 2008	Three months ended March 31, 2007
Basic Earnings per Share:		
Net income	$ 2,922,000	$ 2,594,000
Weighted average common shares outstanding	6,278,128	6,421,397
Basic earnings per common share	$ .47	$ .40
Diluted Earnings per Share:		
Weighted average common shares outstanding	6,278,128	6,421,397
Assumed conversion of stock options	115,427	144,561
Diluted weighted average common shares outstanding	6,393,555	6,565,958
Diluted earnings per common share	$ .46	$ .40

Stock options for 124,813 shares of common stock were not considered in computing diluted earnings per share for 2008 because they were anti-dilutive.

Goodwill and Intangible Assets

The Company has goodwill from business combinations, intangible assets from branch acquisitions, and identifiable intangible assets assigned to core deposit relationships and customer lists of Checkley.

The following table presents gross carrying value and accumulated amortization by major intangible asset class as of March 31, 2008 and December 31, 2007 (in thousands):

	March 31, 2008		December 31, 2007	
	Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Goodwill not subject to amortization (effective 1/1/02)	$ 21,123	$ 3,760	$ 21,123	$ 3,760
Intangibles from branch acquisition	3,015	2,212	3,015	2,161
Core deposit intangibles	5,936	3,333	5,936	3,241
Customer list intangibles	1,904	1,174	1,904	1,126
	$ 31,978	$ 10,479	$ 31,978	$ 10,288

Total amortization expense for the three months ended March 31, 2008 and 2007 was as follows (in thousands):

	March 31, 2008	March 31, 2007
Intangibles from branch acquisition	$ 51	$ 50
Core deposit intangibles	92	119

Customer list intangibles		48		48
	$	191	$	217

Aggregate amortization expense for the current year and estimated amortization expense for each of the five succeeding years is shown in the table below (in thousands):

Aggregate amortization expense:		
For period 01/01/08-3/31/08	$	191
Estimated amortization expense:		
For period 04/01/08-12/31/08	$	574
For year ended 12/31/09	$	730
For year ended 12/31/10	$	704
For year ended 12/31/11	$	704
For year ended 12/31/12	$	380
For year ended 12/31/13	$	313

In accordance with the provisions of SFAS 142, the Company performed testing of goodwill for impairment as of September 30, 2007 and determined that, as of that date, goodwill was not impaired. Management also concluded that the remaining amounts and amortization periods were appropriate for all intangible assets.

Other Assets

The Company owns approximately $3.7 million of Federal Home Loan Bank stock included in other assets. During the third quarter of 2007, the Federal Home Loan Bank of Chicago received a Cease and Desist Order from its regulator, the Federal Housing Finance Board. The Federal Home Loan Bank will continue to provide liquidity and funding through advances; however, the draft order prohibits capital stock repurchases and redemptions until a time to be determined by the Federal Housing Finance Board. The Board of Directors and management of the Federal Home Loan Bank of Chicago have recently announced it will no longer fund mortgage loan purchases through its MPF Program after July 31, 2008. With regard to dividends, the Federal Home Loan Bank continues to assess its dividend capacity each quarter and make appropriate request for approval. There were no dividends paid by the Federal Home Loan Bank of Chicago during the first quarter of 2008.

Repurchase Agreements and Other Borrowings

Securities sold under agreements to repurchase had seasonal declines of $14 million during the first three months of 2008. Other borrowings decreased $8 million during the three-month period ended March 31, 2008. This decrease was primarily due to a decrease of $10 million in Federal Home Loan Bank advances partially offset by an increase in borrowing on our revolving credit line with The Northern Trust Company.

Fair Value of Assets and Liabilities

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157 (FAS 157), “Fair Value Measurements.” FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 has been applied prospectively as of the beginning of the period.

FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fail value.

In accordance with FAS 157, the Company groups its financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities which use observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheet.

Available-for-Sale Securities

The fair value of available-for-sale securities are determined by various valuation methodologies. Where quoted market prices are available in an active market, securities are classified within Level 1. Level 1 securities include exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models or quoted prices of securities with similar characteristics. Level 2 securities include U.S. Treasury securities, obligations of U.S. government corporations and agencies, obligations of states and political subdivisions, mortgage-backed securities, collateralized mortgage obligations and corporate bonds. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include subordinated tranches of collateralized mortgage obligations and investments in financial institution trust preferred securities.

The following table presents the Company's assets that are measured at fair value on a recurring basis and the level within the FAS 157 hierarchy in which the fair value measurements fall as of March 31, 2008 (in thousands):

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities	$ 169,783	$ 42	$ 161,282	$ 8,459

The change in fair value of assets measured using significant unobservable (Level 3) inputs on a recurring basis is summarized as follows (in thousands): :

	Available-for-sale Securities
Balance, December 31, 2007	$ 9,491
Total realized and unrealized gains and losses:	
Included in net income	1
Included in other comprehensive income	(828)
Purchases, issuances and settlements	(205)
Transfers in and/or out of Level 3	-
Balance, March 31, 2008	$ 8,459
Total gains or losses for the period included in net income attributable to the change in unrealized gains or losses related to assets and liabilities still held at the reporting date	$ -

The Company may be required, from time to time, to measure certain other financial assets and liabilities at fair value on a nonrecurring basis. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis in the first three months of 2008 that were still held in the balance sheet at March 31, 2008, the following table provides the level of valuation assumptions used to determine each adjustment and the fair value of the assets at March 31, 2008 (in thousands).

	Carrying value at March 31, 2008			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 4,190	$ -	$ -	$ 4,190