

FIRST MID ILLINOIS BANCSHARES INC  
Form DEF 14A  
March 17, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934 (Amendment No. \_\_\_\_)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for use of the Commission only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material pursuant to Rule 14a-12

FIRST MID-ILLINOIS BANCSHARES, INC.  
(Name of Registrant as Specified in its Charter)

(Name of Person(s) Filing Proxy Statement; if other than the Registrant)

Payment of filing fee (check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
- (1) Title of each class of securities to which transaction applies:
- (2) Aggregate number of securities to which transaction applies:
- (3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11
- (4) Proposed maximum aggregate value of transaction:
- (5) Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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March 17, 2009

Dear Fellow Stockholder:

On behalf of the Board of Directors and management of First Mid-Illinois Bancshares, Inc. (the "Company"), I cordially invite you to attend the Annual Meeting of Stockholders of First Mid-Illinois Bancshares, Inc. to be held at 4:00 p.m. on April 29, 2009, in the lobby of First Mid-Illinois Bank & Trust, 1515 Charleston Avenue, Mattoon, Illinois.

Some of you may have noticed certain changes in the way we are providing proxy materials to you in connection with our 2009 annual meeting. This is because we have elected to provide some of you with access to our proxy materials over the Internet under the Securities and Exchange Commission's new "notice and access" rules. Pursuant to these rules, some of you received in the mail our Notice of Internet Availability of Proxy Materials (the "Notice"), which provided you with instructions on how to access on an internet website this Proxy Statement, the Company's 2008 annual report to stockholders and the Company's Annual Report on Form 10-K for the recently completed fiscal year. Details regarding the business to be conducted at the meeting are described in the Notice and in this Proxy Statement.

At the meeting, we will report on Company operations and the outlook for the year ahead. Directors and officers of the Company, as well as a representative of BKD, LLP, the Company's independent auditors, will be present to respond to any appropriate questions stockholders may have.

I encourage you to attend the meeting in person. Whether or not you plan to attend the meeting, please act promptly to vote your shares. You may vote your shares over the internet or, if you receive or request to receive proxy materials, by mailing, completing, signing and dating a proxy card and returning it in the accompanying postage paid envelope provided. You may also vote your shares by telephone or by following the instructions set forth on the proxy card. Please review the instructions for each of your voting options described in the Notice you may have received in the mail and in this Proxy Statement. If you attend the meeting, you may vote your shares in person, even if you have previously submitted a proxy in writing, by telephone or through the Internet. This will ensure that your shares are represented at the meeting. If you have any questions concerning these matters, please contact me at (217) 258-0415 or Lee Ann Perry, Manager of Shareholder Services, at (217) 258-0493. We look forward with pleasure to seeing and visiting with you at the meeting.

Very truly yours,

FIRST MID-ILLINOIS BANCSHARES, INC.

[Missing Graphic Reference]

William S. Rowland  
Chairman and Chief Executive Officer

1515 Charleston Avenue • P.O. Box 499 • Mattoon, IL 61938 • Phone: (217) 258-0493

[Missing Graphic Reference]

Proxy Statement  
Annual Meeting of Stockholders  
To Be Held April 29, 2009

First Mid-Illinois Bancshares, Inc.  
1515 Charleston Avenue, P.O. Box 499  
Mattoon, Illinois 61938  
(217) 258-0493

GENERAL INFORMATION

This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Directors of First Mid-Illinois Bancshares, Inc. (the "Company") to be voted at the Annual Meeting of Stockholders to be held in the lobby of First Mid-Illinois Bank & Trust, 1515 Charleston Avenue, Mattoon, Illinois, on Wednesday, April 29, 2009 at 4:00 p.m. local time. The Board of Directors would like to have all stockholders represented at the meeting.

Whether or not you plan to attend the Annual Meeting of Stockholders, we encourage you to read this Proxy Statement and submit your proxy as soon as possible. For specific instructions on how to vote your shares, please refer to the instructions on the Notice of Internet Availability of Proxy Materials you may have received in the mail and if you receive or request to receive printed proxy materials, the proxy card. The Company's annual report to stockholders and its Annual Report on Form 10-K for the recently completed fiscal year, which includes the consolidated financial statements of the Company, have been made available with this Proxy Statement.

The Company is a diversified financial services company which serves the financial needs of central Illinois. The Company owns all the outstanding capital stock of First Mid-Illinois Bank & Trust, N.A., a national banking association (the "Bank"), with offices in Mattoon, Charleston, Effingham, Altamont, Neoga, Sullivan, Arcola, Taylorville, Tuscola, Monticello, Urbana, Decatur, Highland, Pocahontas, Champaign, Maryville, Mansfield, Mahomet, and Weldon, Illinois; Mid-Illinois Data Services, Inc., a data processing company ("Data Services"); and The Checkley Agency, Inc., an insurance agency ("Checkley").

Only holders of record of the Company's Common Stock at the close of business on March 2, 2009 (the "Record Date") will be entitled to vote at the annual meeting or any adjournments or postponements of such meeting. On the Record Date, the Company had 6,122,877 shares of Common Stock issued and outstanding. In the election of directors, and for any other matters to be voted upon at the annual meeting, each issued and outstanding share of Common Stock is entitled to one vote.

You may revoke your proxy at any time before it is voted. Unless so revoked, the shares represented by such proxies will be voted at the annual meeting and all adjournments thereof. You may revoke your proxy at any time before it is voted by delivering written notice of revocation to the Secretary of the Company at 1515 Charleston Avenue, P.O. Box 499, Mattoon, Illinois 61938, by executing and delivering a subsequently dated proxy, or by attending the annual meeting and voting in person. Proxies solicited by the Board of Directors of the Company will be voted in accordance with the directions given therein. Where no instructions are indicated, proxies will be voted in accordance with the recommendations of the Board of Directors with respect to the proposals described herein.



A quorum of stockholders is necessary to take action at the annual meeting. The presence, in person or by proxy, of the holders of a majority of the shares of Common Stock of the Company entitled to vote at the meeting will constitute a quorum. Votes cast by proxy or in person at the meeting will be tabulated by the inspector of election appointed for the meeting and will be counted as present for purposes of determining whether a quorum is present. The inspector of election will treat broker non-votes as present and entitled to vote for purposes of determining whether a quorum is present. "Broker non-votes" refers to a broker or other nominee holding shares for a beneficial owner not voting on a particular proposal because the broker or other nominee does not have discretionary voting power regarding that item and has not received instructions from the beneficial owner.

The expenses of solicitation, including the cost of printing and mailing, will be paid by the Company. Proxies are being solicited principally via the Internet and by mail. In addition, directors, officers and regular employees of the Company may solicit proxies personally, by telephone, by fax or by special letter. The Company may also reimburse brokers, nominees and other fiduciaries for their reasonable expenses in forwarding proxy materials to beneficial owners.

#### VOTING SECURITIES AND PRINCIPAL HOLDERS THEREOF

The following table sets forth, as of February 11, 2009, the number of shares of Common Stock beneficially owned by each person known by the Company to be the beneficial owner of more than five percent of the outstanding shares of Common Stock (who are not also directors), each director nominee of the Company, each director, the "named executive officers" (as defined below) and all director nominees, directors and executive officers of the Company as a group. For certain individuals listed below, the number of shares of Common Stock beneficially owned includes the shares of Common Stock into which such individuals may convert their shares of the Company's Series B 9% Non-Cumulative Perpetual Convertible Preferred Stock (the "Preferred Stock"). The Preferred Stock is non-voting stock except with respect to certain fundamental changes in the terms of the Preferred Stock and with respect to certain matters following the Company's failure to pay dividends on the Preferred Stock during four dividend payment periods. Please refer to the footnotes of the following table, and the "Certain Relationships and Related Transactions" section of the Proxy for details.

Name and Address of Beneficial Owner(1)	Amount and Nature of Beneficial Ownership(2)	Percent of Common Stock Outstanding
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##### Principal Stockholders

David R. Hodgman c/o Schiff Hardin LLP 6600 Sears Tower Chicago, Illinois 60606	497,448 (3)	7.9% (19)
Richard Anthony Lumpkin 121 South 17th Street Mattoon, Illinois 61938	629,439 (4)	10.1% (19)



Name and Address of Beneficial Owner(1)	Amount and Nature of Beneficial Ownership(2)	Percent of Common Stock Outstanding
Director Nominees, Directors and Named Executive Officers:		
Charles A. Adams 1020 North 13th Street Mattoon, Illinois 61938	590,765 (5)	9.6% (19)
Kenneth R. Diepholz	49,474 (6)	* % (19)
Joseph R. Dively	19,022 (7)	* % (19)
Steven L. Grissom 121 South 17th Street Mattoon, Illinois 61938	569,824 (8)	9.1% (19)
Benjamin I. Lumpkin 121 South 17th Street Mattoon, IL 61938	315,462 (9)	5.1% (19)
Gary W. Melvin RR 1, Box 226 Sullivan, IL 61951	351,060 (10)	5.7% (19)
Sara Jane Preston	35,164 (11)	* % (19)
William S. Rowland	141,201 (12)	2.3% (19)
Ray Anthony Sparks 30 South Country Club Road Mattoon, IL 61938	381,727 (13)	6.1% (19)
Michael L. Taylor	23,201 (14)	* % (19)
John W. Hedges	49,042 (15)	* % (19)
Charles A. LeFebvre	2,367 (16)	* % (19)
Eric S. McRae	12,784 (17)	* % (19)
All director nominees, directors and executive officers as a group (13 persons)	2,541,093 (18)	38.0% (20)





- (1) Addresses are provided for those beneficial owners owning more than 5% of the Company's Common Stock.
- (2) Unless otherwise indicated, the nature of beneficial ownership for shares shown in this column is sole voting and investment power. The information contained in this column is based upon information furnished to the Company by the persons named above.
- (3) The above amount includes 191,974 shares held by the Richard Anthony Lumpkin 1990 Personal Income Trust for the benefit of Benjamin Iverson Lumpkin dated April 20, 1990, and 191,974 shares held by the Richard Anthony Lumpkin 1990 Personal Income Trust for the benefit of Elizabeth Lumpkin Celio dated April 20, 1990, over which Mr. Hodgman has shared voting and investment power. The above amount also includes 56,750 shares obtainable through the conversion of 250 shares of Preferred Stock held by the Richard Anthony Lumpkin 1990 Personal Income Trust for the benefit of Benjamin Iverson Lumpkin dated April 20, 1990, and 56,750 shares obtainable through the conversion of 250 shares of Preferred Stock held by the Richard Anthony Lumpkin 1990 Personal Income Trust for the benefit of Elizabeth Lumpkin Celio dated April 20, 1990. Mr. Hodgman, who serves as co-trustee of the aforementioned trusts, disclaims beneficial ownership of the foregoing 497,448 shares held by these trusts.
- (4) The above amount includes 44,458 shares held by Mr. Richard Lumpkin individually. The above amount also includes 100,483 shares held by SKL Investment Group, of which Mr. Richard Lumpkin is a voting member and of which Mr. Richard Lumpkin has shared voting and investment power; 112,467 shares held by The Lumpkin Family Foundation, of which Mr. Richard Lumpkin serves as a trustee and has shared voting and investment power, and of which beneficial ownership is disclaimed; 306,806 shares held by the Richard Adamson Lumpkin Trust dated February 6, 1970 for the benefit of Richard Anthony Lumpkin, under which Mr. Richard Lumpkin has sole voting and investment power; and 1,665 shares held for the account of Mr. Richard Lumpkin under the Company's Deferred Compensation Plan. The above amount also includes 22,700 shares obtainable through the conversion of 100 shares of Preferred Stock held by The Lumpkin Foundation; 18,160 shares obtainable through the conversion of 80 shares of Preferred Stock held by the Richard Adamson Lumpkin Trust dated February 6, 1970 for the benefit of Margaret Keon, of which Mr. Richard Lumpkin has sole voting and investment power; and 22,700 shares obtainable through the conversion of 100 shares of Preferred Stock held by the Richard Adamson Lumpkin Trust dated February 6, 1970 for the benefit of Richard Anthony Lumpkin.
- (5) The above amount includes 132,587 shares held by Mr. Adams individually. The above amount also includes 401,523 shares of Common Stock held by a corporation which Mr. Adams is deemed to control; 4,000 shares held by the Howell-Adams Foundation over which Mr. Adams has shared voting and investment power; 49,280 shares held for the account of Mr. Adams under the Company's Deferred Compensation Plan; and options to purchase 3,375 shares of Common Stock.
- (6) The above amount includes 19,882 shares held by Mr. Diepholz individually. The above amount also includes 22,842 shares held for the account of Mr. Diepholz under an Individual Retirement Account; and options to purchase 6,750 shares of Common Stock.
- (7) The above amount includes 2,846 shares held by Mr. Dively individually; 3,721 shares held for the account of Mr. Dively under the Company's Deferred Compensation Plan; and options to purchase 3,375 shares of common stock. The above amount also includes 9,080 shares obtainable through the conversion of 40 shares of Preferred Stock held by Mr. Dively individually.
- (8) The above amount includes 31,680 shares held by Mr. Grissom individually; and 9,213 shares held jointly with his spouse. The above amount also includes 191,974 shares held by the Richard Anthony Lumpkin 1990 Personal Income Trust for the benefit of Benjamin Iverson Lumpkin dated April 20, 1990, and 191,974 shares held by the

Richard Anthony Lumpkin 1990 Personal Income Trust for the benefit of Elizabeth Lumpkin Celio dated April 20, 1990, over which Mr. Grissom has shared voting and investment power. The above also includes 18,160 shares obtainable through the conversion of 80 shares of Preferred Stock held by Mr. Grissom jointly with his spouse; 56,750 shares obtainable through the conversion of 250 shares of Preferred Stock held by the Richard Anthony Lumpkin 1990 Personal Income Trust for the benefit of Benjamin Iverson Lumpkin dated April 20, 1990; and 56,750 shares obtainable through the conversion of 250 shares of Preferred Stock held by the Richard Anthony Lumpkin 1990 Personal Income Trust for the benefit of Elizabeth Lumpkin Celio dated April 20, 1990. Mr. Grissom, who serves as co-trustee of the aforementioned trusts, disclaims beneficial ownership of the foregoing 497,448 shares held by these trusts. The above amount also includes 2,073 shares held for the account of Mr. Grissom under the Company's Deferred Compensation Plan; and options to purchase 11,250 shares of Common Stock.

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- (9) The above amount includes 281,412 shares held by Mr. Benjamin Lumpkin individually. The above amount also includes 34,050 shares obtainable through the conversion of 150 shares of Preferred Stock held by Mr. Benjamin Lumpkin individually. Mr. Benjamin Lumpkin is also the beneficiary of the Richard Anthony Lumpkin 1990 Personal Income Trust for the benefit of Benjamin Iverson Lumpkin dated April 20, 1990 which holds 191,974 shares and 250 shares of Preferred Stock convertible to 56,750 shares. Mr. Benjamin Lumpkin does not have beneficial ownership of the shares held by this trust.
- (10) The above amount includes 264,218 shares held by Mr. Melvin individually. The above amount also includes 38,067 shares held for the account of Mr. Melvin under the Company's Deferred Compensation Plan and options to purchase 3,375 shares of Common Stock. The above amount also includes 45,400 shares obtainable through the conversion of 200 shares of Preferred Stock held jointly by Mr. Melvin and his spouse.
- (11) The above amount includes 8,324 shares held by Ms. Preston individually. The above amount also includes 6,510 shares held for the account of Ms. Preston under the Company's Deferred Compensation Plan and options to purchase 11,250 shares of Common Stock. The above amount also includes 9,080 shares obtainable through the conversion of 40 shares of Preferred Stock held by Ms. Preston individually.
- (12) The above amount includes 14,470 shares held by Mr. Rowland individually. The above amount also includes 24,844 shares for the account of Mr. Rowland under an Individual Retirement Account; 8,641 shares held for the account of Mr. Rowland under the Company's 401(k) Plan; 6,396 shares held for the account of Mr. Rowland under the Company's Deferred Compensation Plan; and options to purchase 75,500 shares of Common Stock. The above amount also includes 11,350 shares obtainable through the conversion of 50 shares of Preferred Stock held jointly by Mr. Rowland and his spouse.
- (13) The above amount includes 145,232 held by Mr. Sparks individually. The above amount also includes 86,523 shares held by Sparks Investment Group, LP, and 18,880 shares held by the Sparks Foundation over which Mr. Sparks shares voting and investment power; 1,822 shares by Mr. Sparks' child, over which Mr. Sparks has shared voting and investment power; 19,205 shares held for the account of Mr. Sparks under the Company's Deferred Compensation Plan; and options to purchase 3,375 shares of Common Stock. The above amount also includes 83,990 shares obtainable through the conversion of 370 shares of Preferred Stock held by Mr. Sparks individually, and 22,700 shares obtainable through the conversion of 100 shares of Preferred Stock held Sparks Investment Group, LP.
- (14) The above amount includes 1,293 shares held for the account of Mr. Taylor under the Company's 401(k) Plan and options to purchase 21,000 shares of Common Stock. The above amount also includes 908 shares obtainable through the conversion of 4 shares of Preferred Stock held by Mr. Taylor individually.
- (15) The above amount includes 225 shares held by Mr. Hedges individually and 337 shares held jointly with his spouse. The above amount also includes 1,395 shares held for the account of Mr. Hedges under the Company's 401(k) Plan; 5,252 shares held for the account of Mr. Hedges under the Company's Deferred Compensation Plan; and options to purchase 39,563 shares of Common Stock. The above amount also includes 1,135 shares obtainable through the conversion of 5 shares of Preferred Stock held by Mr. Hedges individually, and 1,135 shares obtainable through the conversion of 5 shares of Preferred Stock held jointly by Mr. Hedges and his spouse.
- (16) The above amount includes 482 shares held for the account of Mr. LeFebvre under the Company's Deferred Compensation Plan; and options to purchase 750 shares of Common Stock. The above amount also includes 1,135 shares obtainable through the conversion of 5 shares of Preferred Stock held by Mr. LeFebvre individually.
- (17)

The above amount includes 1,410 shares held for the account of Mr. McRae under the Company's 401(k) Plan and options to purchase 7,969 shares of Common Stock. The above amount also includes 3,405 shares obtainable through the conversion of 15 shares of Preferred Stock held by Mr. McRae individually.

(18) Includes an aggregate of 187,532 shares obtainable upon the exercise of options, and an aggregate 355,028 shares obtainable through the conversion of Preferred Stock.

(19) Percentage is calculated on a partially diluted basis, assuming only the exercise of stock options by such individual which are exercisable within 60 days, and the conversion of Preferred Stock held by such individual.

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(20) Percentage is calculated on a partially diluted basis, assuming the exercise of all stock options which are exercisable within 60 days by individuals included in the above table, and the conversion of the Preferred Stock held by such individuals.

\* Less than 1%.

As of February 1, 2009, the Bank acted as sole or co-fiduciary with respect to trusts and other fiduciary accounts which own or hold 180,943 shares or 2.9% of the outstanding Common Stock of the Company, over which the Bank has sole voting and investment power with respect to 156,631 shares or 2.6% of the outstanding Common Stock and shared voting and investment power with respect to 24,313 shares or .4% of the outstanding Common Stock.

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## PROPOSAL I - ELECTION OF DIRECTORS

The directors of the Company are divided into Classes I, II and III having staggered terms of three years. For this year's annual stockholders meeting, the Board of Directors has nominated for election as Class II directors, for a term expiring in 2012, Joseph R. Dively, Sara Jane Preston and William S. Rowland. Messrs. Dively and Rowland have served as directors of the Company since 2004 and 1991, respectively. Ms. Preston has served as a director of the Company since 2000. The three individuals receiving the highest number of votes cast will be elected as directors of the Company and will serve as Class II directors for a three-year term. Broker non-votes, because they are not considered votes cast, will not be counted in the vote totals. The Company has no knowledge that any of the nominees will refuse or be unable to serve, but if any of the nominees becomes unavailable for election, the holders of the proxies reserve the right to substitute another person of their choice as a nominee when voting at the meeting.

At a meeting of the Board on January 27, 2009, the Board appointed Benjamin I. Lumpkin to fill a vacancy in the Class III directors created by the death of the Company's former chief executive officer and director, Daniel E. Marvin, Jr. Mr. Benjamin Lumpkin was appointed to serve until the expiration of the Class III directors' term in 2010. Mr. Benjamin Lumpkin was recommended to the Board for appointment to the Board by Mr. Richard Lumpkin, a current stockholder of the Company, a former director of the Company and the father of Mr. Benjamin Lumpkin.

The following table sets forth as to each nominee and director continuing in office, his or her name, age, principal occupation and the year he or she first became a director of the Company. Unless otherwise indicated, the principal occupation listed for each person below has been his or her occupation for the past five years.

Name	Age at March 17, 2009	Principal Occupation	Year First Became Director	Year Term Expires
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## DIRECTOR NOMINEES

Joseph R. Dively	49	Director of the Bank and the Company (since 2004); Senior Vice President of Consolidated Communications Holdings, Inc., a telecommunications holding company, and President of Illinois Telephone Operations, a local telecommunications provider (since 2003); Vice President of Illinois Consolidated Telephone Company, a local telecommunications provider (until 2002).	2004	2009
Sara Jane Preston	68	Director of the Bank (since 1999) and of the Company; Director of Checkley (since 2002); retired President and CEO of Charleston National Bank and the southern Illinois lending operations of its successor organizations (Boatmen's National Bank, NationsBank and BankAmerica).	2000	2009

William S. Rowland	62	Chairman, President, Chief Executive Officer and Director of the Company (since 1999); Executive Vice President (1997-1999), Treasurer and Chief Financial Officer (1989-1999) of the Company; Director of Data Services (since 1989); Director (since 1999), Chairman (since 1999), and Executive Vice President (1989-1999) of the Bank; Director of Checkley (since 2002).	1991	2009
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The Board of Directors recommends a vote "FOR" the election of Directors Dively, Preston and Rowland for a term of three years.



## DIRECTORS CONTINUING IN OFFICE

Charles A. Adams	67	Director of the Bank (since 1989) and of the Company; Director of Data Services (since 1987); Director of Checkley (since 2002); President, Howell Paving, Inc., a road construction company (since 1983).	1984	2010
Ray Anthony Sparks	52	Director of the Bank (since 1997) and of the Company; Director of Data Services (since 1996); Director of Checkley (since 2002); private investor (since 1997); former President of Elasco Agency Sales, Inc. and Electric Laboratories and Sales Corporation, a distributor of electrical supplies (until 1997).	1994	2010
Benjamin I. Lumpkin	36	Director of the Bank (since 2009) and of the Company; Owner of Big Toe Press, LLC, a film production company (since 2004); Member of SKL, LLC Investment Group Finance Committee, a private investment company (since 2000).	2009	2010
Kenneth R. Diepholz	70	Director of the Bank (since 1984) and of the Company; Vice President, Ken Diepholz Chevrolet, Inc., an automobile dealership (since 2000); Vice President, Diepholz Auto Group, an automobile dealer group (since 2003); Owner, Diepholz Rentals, a renter of apartments and commercial real estate property.	1990	2011
Steven L. Grissom	56	Director of the Bank and the Company (since 2000); Treasurer and Secretary of Consolidated Communications Holdings, Inc., and its predecessors, a telecommunications holding company (2003-2006); Treasurer of Illinois Consolidated Telephone Company, a local telecommunications provider (until 2006); Secretary of Illinois Consolidated Telephone Company, a local telecommunications provider (2003-2006); Administrative Officer of SKL Investment Group, LLC, a private investment company (since 1997).	2000	2011
Gary W. Melvin	60	Director of the Bank (since 1984) and of the Company; Director of Data Services (since	1990	2011

1987); President and Co-Owner, Rural King Farm & Home Supplies stores, a retail farm and home supply store chain.

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## CORPORATE GOVERNANCE MATTERS

### BOARD OF DIRECTORS

The Board of Directors concluded that except for Mr. Rowland, the members of the Board of Directors satisfy the independence requirements of the New York Stock Exchange. The Board of Directors has established an audit committee and a compensation committee. The Board of Directors has concluded that all members of the audit committee satisfy the independence requirements of the New York Stock Exchange, as required by the charter of the audit committee. The Board of Directors has also concluded that all current members of the compensation committee satisfy the independence requirements of the New York Stock Exchange. The Board has also created other company-wide committees composed of officers of the Company and its subsidiaries.

A total of 12 regularly scheduled and special meetings were held by the Board of Directors during 2008. During 2008, all directors attended at least 75 percent of the meetings of the Board and the committees on which they served.

### NOMINATIONS FOR DIRECTOR

The Company does not maintain any standing nominating committee. The entire Board performs the functions of a nominating committee, and considers and acts on all matters relating to the nomination of individuals for election as directors. The Board does not believe it needs a separate nominating committee because the Board has the time and resources to perform the function of selecting director nominees. Also, all but one of the directors satisfy the independence requirements of the New York Stock Exchange. When the Board performs its nominating function, the Board acts in accordance with the Company's Certificate of Incorporation.

In the consideration of director nominees, the Board of Directors considers, at a minimum, the following factors for new directors, or the continued service of existing directors: (1) the ability of the prospective nominee to represent the interests of the stockholders of the Company; (2) the prospective nominee's standards of integrity, commitment and independence of thought and judgment; (3) the prospective nominee's ability to dedicate sufficient time, energy and attention to the diligent performance of his or her duties; and (4) the extent to which the prospective nominee contributes to the range of talent, skill and expertise appropriate for the Board.

Any stockholder who wishes to recommend a director candidate for consideration by the Board should submit such recommendation in writing to the Board at the address set forth below under "Communications with Directors." A candidate recommended for consideration must be highly qualified and must be willing and able to serve as director. Director candidates recommended by stockholders will receive the same consideration given to other candidates and will be evaluated against the criteria above.

### NOTICE PROVISIONS FOR STOCKHOLDER NOMINATIONS OF DIRECTORS

Any stockholder wishing to nominate an individual for election as a director at the Annual Meeting must comply with certain provisions in the Company's Certificate of Incorporation. The Company's Certificate of Incorporation establishes an advance notice procedure with regard to the nomination, other than by or at the direction of the Board of Directors, of candidates for election as directors. If the notice is not timely and in proper form, the proposed nomination will not be considered at the Annual Meeting. Generally, such notice must be delivered to or mailed to and received by the Secretary of the Company not fewer than 14 days or more than 60 days before a meeting at which

directors are to be elected. To be in proper form, each written nomination must set forth: (1) the name, age business address and, if known, the residence address of the nominee, (2) the principal occupation or employment of the nominee for the past five years, and (3) the number of shares of stock of the Company beneficially owned by the nominee and by the nominating stockholder. The stockholder must also comply with certain other provisions set forth in the Company's Certificate of Incorporation relating to the nomination of an individual for election as a director. For a copy of the Company's Certificate of Incorporation, which includes the provisions relating to the nomination of an individual for election as a director, an interested stockholder should contact the Secretary of the Company at 1515 Charleston Avenue, P.O. Box 499, Mattoon, Illinois 61938.

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#### AUDIT COMMITTEE

The members of the audit committee of the Company during the fiscal year ended December 31, 2008 were Messrs. Adams, Diepholz, Dively, Grissom, Marvin, Melvin and Sparks, and Ms. Preston. The audit committee met 6 times in 2008. Mr. Marvin served on this committee until his death in April 2008. He attended two committee meetings. Mr. Benjamin Lumpkin was appointed to this committee in January 2009. The audit committee assists the Board of Directors with the review of the Company's financial statements and the Company's compliance with applicable legal and regulatory requirements. Additionally, the audit committee appoints, and is directly responsible for the oversight of, the independent auditor, pre-approves all services performed for the Company by the independent auditor and oversees the Company's internal audit function. The audit committee may also retain independent legal, accounting or other advisors as it may deem necessary in order to carry out its duties.

The Board of Directors determined that each member of the audit committee satisfies the independence requirements of the New York Stock Exchange. The Securities and Exchange Commission requires that boards of directors determine whether any audit committee member qualifies as an "audit committee financial expert." The Board of Directors determined that Steven L. Grissom is an audit committee financial expert.

The audit committee acts pursuant to a written charter that was reviewed and reassessed for adequacy and reaffirmed by the Board of Directors on January 27, 2009. A copy of the audit committee charter may be found on the Company's website at [www.firstmid.com](http://www.firstmid.com). The audit committee will continue to review and reassess the charter from time to time but not less than annually.

#### COMPENSATION COMMITTEE

The members of the compensation committee of the Company during the fiscal year ended December 31, 2008 were Messrs. Adams, Diepholz, Dively, Grissom, Melvin and Sparks, and Ms. Preston. The compensation committee met 3 times in 2008. Mr. Benjamin Lumpkin was appointed to this committee in January 2009. The compensation committee reports to the Board of Directors and has responsibility for all matters related to compensation of executive officers of the Company, including reviewing and approving base salaries, conducting a review of executive officers' salary, incentive compensation, retirement benefits and fringe benefits compared to other financial services companies in the region, and using its best judgment in determining that total executive compensation reflects the Company's mission, strategy and performance. Additionally, a sub-committee of the compensation committee made up of Messrs. Adams, Melvin and Sparks and Ms. Preston, has responsibility for administering the stock incentive plans of the Company. For information about the role of the compensation committee with respect to executive compensation, see the "Compensation Discussion and Analysis" section of this proxy statement.

#### COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

During the fiscal year ended December 31, Messrs. Hedges and Sparks served as directors, and Mr. Grissom served as President, of Mattoon Area Industrial Development Corporation, a not-for-profit industrial development corporation; and Messrs. Dively and Hedges served as directors and members of the compensation committee of Sarah Bush Lincoln Health Systems, a not-for-profit medical facility. See also "Certain Relationships and Related Transactions."

## COMMUNICATIONS WITH DIRECTORS

Any stockholder may communicate with any director by sending written correspondence addressed to such director in care of the Secretary of the Company at First Mid-Illinois Bancshares, Inc., 1515 Charleston Avenue, Mattoon, Illinois 61938. The Secretary or the designee thereof will forward such correspondence to the relevant director.

The Company expects directors to attend the annual meeting, absent scheduling or other similar conflicts. All of the then current directors attended the Company's 2008 Annual Meeting of Stockholders.

## SECTION 16 - BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based solely upon its review of reports on Forms 3, 4 and 5 and any amendments furnished to the Company under Section 16 of the Securities Exchange Act of 1934, and written representations from the executive officers and directors that no other reports were required, the Company believes that all of these Forms were filed on a timely basis by reporting persons during the fiscal year ended December 31, 2008.

## REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

The audit committee reviewed and discussed with management the Company's audited financial statements as of and for the fiscal year ended December 31, 2008.

The audit committee also discussed with the independent auditors, BKD, LLP, the matters required to be discussed by Statement on Auditing Standards No. 61, Communication with Audit Committees, as amended, as adopted by the Public Company Accounting Oversight Board in Rule 3200T. The audit committee received the written disclosures and the letter from BKD, LLP required by applicable requirements of the Public Company Accounting Oversight Board regarding BKD, LLP's communications with the audit committee concerning independence, and discussed with BKD, LLP the independence of that firm.

Based on the review and discussion referred to above, the audit committee recommended to the Board of Directors that the audited financial statements referred to above be included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

This audit committee report is submitted by the audit committee of the Board of Directors:

Ray Anthony Sparks, Chairman	Steven L. Grissom
Charles A. Adams	Benjamin I. Lumpkin
Kenneth R. Diepholz	Gary W. Melvin
Joseph R. Dively	Sara Jane Preston

## FEES OF INDEPENDENT AUDITORS

**Audit Fees.** The aggregate fees billed for professional services rendered by BKD, LLP for the audit of the Company's annual financial statements for the fiscal years ended December 31, 2008 and 2007, the audit of the Company's internal control over financial reporting as of December 31, 2008 and 2007, and the review of the financial statements included in the Company's Quarterly Reports on Form 10-Q for 2008 and 2007 were \$192,115 and \$187,380 respectively.

**Audit-Related Fees.** The aggregate fees billed for professional services rendered by BKD, LLP for audit-related services for the fiscal years ended December 31, 2008 (namely, employee benefit plan audit) and 2007 (namely, consent for the Company's S-8 filing, employee benefit plan audit and FHLB audit) were \$13,645 and \$18,140 respectively.

**Tax Fees.** The aggregate fees billed for professional services rendered by BKD, LLP for the fiscal years ended December 31, 2008 and 2007 (namely preparation of consolidated tax return and tax advice) were \$21,760 and \$28,530 respectively.

**All Other Fees.** For the fiscal years ended December 31, 2008 and 2007, no fees were billed for products or services provided by BKD, LLP other than the foregoing.

The audit committee pre-approves all auditing services and permitted non-audit services provided by the independent auditors. These services may include audit services, audit-related services, tax services and other services. The audit committee preapproved all services performed by the independent auditors in 2008.

## INDEPENDENT PUBLIC ACCOUNTANTS

BKD, LLP acted as independent certified public accountants of the Company and its subsidiaries for the fiscal years ending December 31, 2008 and 2007. BKD, LLP has served as the Company's independent auditors since July 26, 2005.

A representative from BKD, LLP is expected to be present at the annual meeting, will have the opportunity to make a statement and will be available to respond to appropriate questions. The Company has not yet appointed its independent auditors for the fiscal year ending December 31, 2009. The Company expects to appoint its independent auditors for 2009 at its March meeting of the Board of Directors.

## COMPENSATION COMMITTEE REPORT

The compensation committee has reviewed and discussed with the Company's management the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K and, based on such review and discussion, the compensation committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement.

This compensation committee report is submitted by the compensation committee of the Board of Directors:

Kenneth R. Diepholz,  
Chairman  
Charles A. Adams  
Joseph R. Dively  
Steven L. Grissom

Benjamin I. Lumpkin  
Gary W. Melvin  
Sara Jane Preston  
Ray Anthony Sparks

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## EXECUTIVE COMPENSATION

### COMPENSATION DISCUSSION AND ANALYSIS

This Compensation Discussion and Analysis explains the objectives and philosophy underlying the Company's executive compensation program and the material elements of the compensation paid to the Company's executive officers, including the executive officers named in the Summary Compensation Table of this proxy statement (the "named executive officers").

#### Executive Compensation Objectives

The Company's compensation objectives with respect to its named executive officers are to:

- Provide incentive to maximize stockholder value by aligning the executives' interests with those of the stockholders.
  - Enable the Company to attract and retain the best available executive talent.
    - Reward individual performance and contributions to the Company.

#### Setting Executive Compensation

The compensation committee attempts to meet these objectives by providing a mix of key compensation elements that include base salary, annual cash incentives and equity-based compensation. In setting aggregate compensation for each of the named executive officers, the compensation committee first establishes appropriate levels of base salary for the executives, then establishes the opportunity for the executives to earn additional compensation through annual cash incentives and longer-term equity compensation. The amount of such additional compensation varies with base salary and, in the case of annual cash incentives, is also conditioned on attainment of both individual and corporate performance measures. The Company also provides retirement benefits, severance and change in control benefits, and a limited number of perquisites and other personal benefits.

The compensation committee uses the key elements of compensation to meet the objectives of its executive compensation program as follows:

Provide incentive to maximize stockholder value by aligning the executives' interests with those of the stockholders. The compensation committee has used stock options as a way to unify the interests of the executives and stockholders. Issuing options that have a 10 year term and incrementally vest over time, but only so long as the executive remains employed by the Company, encourages an executive to increase the Company's stock value over time. The compensation committee granted 27,500 options to certain executives of the Company during 2008. The compensation committee also bases a significant portion of an executive's cash incentive on attainment of certain earnings per share levels, which encourages the executive to work to increase stock value.

Enable the Company to attract and retain the best available talent. In order to achieve this objective, the compensation committee believes it must pay compensation that is competitive. As described below, the compensation committee reviews and monitors the compensation paid by companies that are comparable to the Company to ensure that compensation packages are competitive.

Reward individual performance and contributions to the Company. The compensation committee's evaluation of the individual performance of each executive affects his or her compensation. Individual performance is an important factor in determining base salary, which in turn affects the amount of cash incentive compensation that can be earned. Individual performance is also a component of the cash incentive compensation.

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The compensation committee makes all compensation decisions for the CEO and all other executive officers of the Company. The CEO annually reviews the performance of each executive officer and makes recommendations to the compensation committee. The compensation committee considers the CEO's recommendations when making its final compensation decisions for all executives other than the CEO. Although the compensation committee has the discretion to make all final decisions, the recommendation of the CEO is an important factor. The compensation committee believes that its ability to exercise discretion in setting the elements of compensation for its executives provides flexibility to establish appropriate overall compensation levels and achieve the Company's objectives.

## Key Elements of Compensation

### Base Salary

Each year the compensation committee reviews salary data of the top paid executives of other comparable banking institutions. This data includes salary surveys prepared by the Illinois Bankers Association and the accounting firm of Crowe Chizek and Company LLC, as well as compensation information obtained from proxy statements, of publicly traded banks in non-urban markets in the upper Midwest who directly compete with the Company or who have market capitalization comparable to that of the Company (the banks included in the 2008 analysis ranged in size from approximately \$525 million to \$4.3 billion in assets). These institutions frequently recruit individuals for senior executive positions requiring similar skills and backgrounds to the individuals recruited by the Company. The compensation committee uses this information as a general guide in establishing the base salaries of the named executive officers. However, the compensation committee does not rely solely on this information and does not benchmark its salary decisions to any particular percentile range of the comparator group of companies. The compensation committee also considers each executive's current salary, his or her individual performance, the financial performance of the Company, the anticipated difficulty of replacing the executive with a person of comparable experience and skill, and the recommendation of the CEO.

Based on these guidelines and factors, the compensation committee concluded that adjustments to base salaries for certain named executive officers were necessary in order to keep compensation for named executive officers competitive. In addition to the factors noted above, the compensation committee considered the accomplishment level of individual goals set at the beginning of the year, the number of individuals the executive supervises and the strategic implications of the decisions the executive is required to make. Mr. LeFebvre began his employment with the Company in April, 2007. He did not receive a salary increase for 2008 in accordance with the Company's general policy that executives have a minimum of one year of service before they are eligible for salary increases. The compensation committee established the 2008 base salary for the named executive officers, effective as of February 1, 2008, as follows:

Executive	2008 Salary Rate	\$ Increase from 2007 Salary Rate
Mr. Rowland	\$290,000	\$15,000
Mr. Taylor	\$150,000	\$13,000
Mr. Hedges	\$173,000	\$5,000
Mr. McRae	\$145,000	\$15,000
Mr. LeFebvre	\$135,000	\$0

The actual salaries paid to the named executive officers in 2008 are set forth in the “Salary” column of the Summary Compensation Table of this proxy statement.

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## Annual Cash Incentives

The named executive officers are eligible to participate in the Company's Incentive Compensation Plan, which is designed to reward the executives in increasing Company profitability and achieving individual accomplishments which create stockholder value. The corporate component of the plan is intended to reflect the Company's philosophy that stockholders should first receive a certain amount of increased value before the executives receive any cash incentive compensation. During 2008, the plan used fully diluted earnings per share (EPS) as the metric to determine this amount of annual profitability improvement. The plan operated as follows:

- At the beginning of 2008, the compensation committee determined the amount of cash incentive each named executive officer was entitled to receive as a percentage of his or her base salary rate in effect for 2008. The compensation committee also determined the portion of the incentive opportunity that would be based on the EPS component (the remaining portion being based on individual performance goals). The amounts established for 2008 were as follows:

Executive	% of Salary Payable as Cash Incentive	% of Cash Incentive Tied to EPS
Mr. Rowland	50%	60%
Mr. Taylor	35%	60%
Mr. Hedges	35%	50%
Mr. McRae	20%	50%
Mr. LeFebvre	25%	50%

The percentage of salary payable as cash incentive is consistent with the amounts specified in each named executive officer's employment agreement. The CEO and CFO had a larger percentage of their incentive tied to EPS due to their level of responsibility in overall Company functions rather than to specific business lines.

- At the same time, the compensation committee established the EPS target using the prior year's EPS as a starting point. In 2007, the Company's EPS was \$1.57 (adjusted for stock split which occurred in June 2007). Using this amount as a base line, the compensation committee determined the following 2008 criteria:
- "Minimum" EPS of \$1.57: If 2008 EPS is below \$1.57, no cash incentive compensation will be paid to any executive.
- "Threshold" EPS of \$1.61: Attainment of this level results in executives receiving 25% of their cash incentive opportunity.
- "Budget" EPS of \$1.65: Attainment of this level results in executives receiving 60% of their cash incentive opportunity.
- "Superior" EPS of \$1.73: Attainment of this level results in executives receiving 100% of their cash incentive opportunity.

The compensation committee has the discretion to pay a prorated portion of the cash incentive opportunity for attainment of EPS levels between minimum, threshold, budget and maximum, or for attainment of EPS levels above maximum.

Operations for 2008 resulted in EPS of \$1.67. The compensation committee exercised its discretion to pay a pro rata amount to reflect attainment of EPS between the budget and superior levels, which resulted in executives receiving 70% or the portion of their bonus opportunity based on the EPS component.

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The remaining portion of the cash incentive opportunity for each executive (40% for Messrs. Rowland and Taylor and 50% for Messrs. Hedges, McRae and LeFebvre) was based on achievement of individual objectives:

- Mr. Rowland had two individual objectives, each with a weighting of 20%: increasing the number of households with four or more accounts; and maintaining asset quality. The compensation committee determined that neither of these individual objectives was met for 2008.

Objective	Weighting	2008 Goal			Actual	% Achieved
		Threshold	Budget	Superior		
# Households with four or more bank products	20%	9,020	9,195	9,545	8,985	0%
% Nonperforming assets to average loans	20%	0.78%	0.65%	0.52%	1.20%	0%

- Mr. Taylor had two individual objectives, each with a weighting of 20%: increasing the number of households with four or more accounts; and lowering the overhead of the Company. The compensation committee determined that neither of these individual objectives was met for 2008.

Objective	Weighting	2008 Goal			Actual	% Achieved
		Threshold	Budget	Superior		
# Households with four or more bank products	20%	9,020	9,195	9,545	8,985	0%
Level of bank overhead (in thousands)	20%	\$14,350	\$14,000	\$13,800	\$14,801	0%

- Mr. Hedges had three individual objectives: increasing the number of households with four or more accounts, with a weighting of 15%; maintaining asset quality, with a weighting of 25%; and maintaining profitability of the bank's Mattoon operations, with a weighting of 10%. The compensation committee determined that Mr. Hedges attained an aggregate of 20% of his individual objectives for 2008.

Objective	Weighting	2008 Goal			Actual	% Achieved
		Threshold	Budget	Superior		
# Households with four or more bank products	15%	9,020	9,195	9,545	8,985	0%
% Nonperforming assets to average loans	25%	0.78%	0.65%	0.52%	1.20%	0%
Net income for Mattoon region (in thousands)	10%	\$3,500	\$3,700	\$3,900	\$4,095	100%





- Mr. McRae had four individual objectives, all related to the Decatur region operations: increasing the number of households in the Decatur region with four or more accounts, with a weighting of 10%; maintaining asset quality in the Decatur region, with a weighting of 20%; maintaining profitability of the bank's Decatur region operations, with a weighting of 10%; and achieving return on assets for the Decatur region, with a weighting of 10%. The compensation committee determined that Mr. McRae attained an aggregate of 40% of his individual objectives for 2008.

Objective	Weighting	2008 Goal			Actual	% Achieved
		Threshold	Budget	Superior		
# Households with four or more bank products for Decatur region	10%	2,057	2,107	2,207	2,049	0%
% Nonperforming assets to average loans for Decatur region	20%	0.75%	0.70%	0.65%	0.63%	100%
Net Income for Decatur region (in thousands)	10%	\$3,850	\$4,044	\$4,253	\$3,582	0%
Return on assets for Decatur region	10%	1.67%	1.75%	1.84%	1.15%	0%

- Mr. LeFebvre had four individual objectives, all related to the Wealth Management Division: increasing the number of trust and brokerage customers, with a weighting of 10%; maintaining profitability of the trust and brokerage departments, with a weighting of 20%; achieving return on assets for the Wealth Management Division, with a weighting of 10%; and success of subordinates' attainment of individual objectives, with a weighting of 10%. The compensation committee determined that Mr. LeFebvre attained an aggregate of 69% of his individual objectives for 2008.

Objective	Weighting	2008 Goal			Actual	% Achieved
		Threshold	Budget	Superior		
# of Trust & Brokerage customers	10%	2,600	27.5	25.9	27.2	25.7
Operating expenses		29.0	23.0	27.5	22.3	
Depreciation		9.1	8.1	8.7	7.8	
Preopening expenses and store development costs		0.0	0.0	0.0	0.3	
General and administrative expenses		7.4	10.6	8.1	11.1	
Total costs and expenses		107.0	100.7	105.9	100.1	
LOSS FROM OPERATIONS		(7.0)	(0.7)	(5.9)	(0.1)	
OTHER EXPENSE:						
Interest expense		(11.9)	(10.7)	(10.7)	(10.4)	

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Other expense/amortization of financing cost	(0.5)	(2.4)	(0.5)	(2.3)
Other expense, net	(12.4)	(13.1)	(11.2)	(12.7)
NET LOSS	(19.4)%	(13.8)%	(17.1)%	(12.8)%

**Results of Operations for the Three and Six Months Ended June 29, 2003 and June 30, 2002**

**Revenues**

Revenues decreased 12.9% to \$3,563,971 in the second quarter of 2003 from \$4,091,023 in the second quarter of 2002, and decreased 11.2% to \$7,497,372 for the first six months of 2003 from \$8,438,543 for the first six months of 2002. The decreases were mainly due to a weak economy. Increased advertising during the first six months of 2003 has not yielded increase revenues to date. We believe that increased spending on marketing, including the use of a sustained, professionally managed marketing program, will increase revenues at our existing units.

**Cost of Sales**

Cost of sales, which consists of food, merchandise and brewing supplies, decreased 10.5% to \$1,211,410 in the second quarter of 2003 compared to \$1,353,827 in the second quarter of 2002, and decreased 7.0% to \$2,581,424 for the first six months of 2003 compared to \$2,775,745 for the first six months of 2002. As a percentage of revenues, cost of sales increased to 34.0% in the second quarter of 2003 as compared to 33.1% in the second quarter of 2002, and increased to 34.4% in the first six months of 2003 as compared to

32.9% in the first six months of 2002. The increases as a percentage of revenues were due to a decrease in menu prices as part of an effort to be more price competitive.

### **Restaurant Salaries and Benefits**

Restaurant salaries and benefits, which consist of restaurant management and hourly employee wages and benefits, payroll taxes and workers compensation insurance, decreased 7.6% to \$978,095 in the second quarter of 2003 compared to \$1,059,013 in the second quarter of 2002, and decreased 5.7% to \$2,040,914 in the first six months of 2003 compared to \$2,164,105 in the first six months of 2002. As a percentage of revenues, restaurant salaries and benefits increased to 27.5% in the second quarter of 2003 as compared to 25.9% in the second quarter of 2002, and increased to 27.2% in the first six months of 2003 as compared to 25.7% in the first six months of 2002. The increases as a percentage of revenues were due to increased workers compensation insurance and lower than anticipated sales.

### **Operating Expenses**

Operating expenses, which include supplies, utilities, repairs and maintenance, advertising and occupancy costs, increased 9.7% to \$1,033,909 in the second quarter of 2003 compared to \$942,799 in the second quarter of 2002, and increased 9.2% to \$2,057,572 for the first six months of 2003 compared to \$1,883,912 for the first six months of 2002. As a percentage of revenues, operating expenses increased to 29.0% in the second quarter of 2003 as compared to 23.0% in the second quarter of 2002, and increased to 27.5% in the first six months of 2003 as compared to 22.3% in the first six months of 2002. The increases were due to increases in employee food expense, insurance cost and marketing and advertising expense.

### **Depreciation**

Depreciation expenses decreased 1.7% to \$324,932 in the second quarter of 2003 compared to \$330,575 in the second quarter of 2002, and decreased 1.7% to \$649,864 for the first six months of 2003 compared to \$661,150 for the first six months of 2002. As a percentage of revenues, these expenses increased to 9.1% in the second quarter of 2003 from 8.1% in the second quarter of 2002, and increased to 8.7% in the first six months of 2003 as compared to 7.8% in the first six months of 2002. Our depreciation expenses change as our assets become fully depreciated.

### **Preopening Expenses and Store Development Costs**

Preopening expenses and store development costs consist of expenses incurred prior to the opening of a new unit, including but not limited to wages and benefits, relocation costs, supplies, advertising expenses and training costs. We incurred no preopening expenses and store development costs in the second quarter of 2003, the first six months of 2003 or the second quarter of 2002. We incurred preopening expenses and store development costs of \$19,930 for the first six months of 2002.

**General and Administrative Expenses**

General and administrative expenses decreased 39.0% to \$265,194 in the second quarter of 2003 compared to \$434,926 in the second quarter of 2002, and decreased 35.0% to \$610,051 for the first six months of 2003 compared to \$939,094 for the first six months of 2002. The decreases reflected a decrease in professional fees related to the cessation of legal proceedings involving the Nashville site and the Grapevine unit and a reduction in corporate compensation. As a percentage of revenue, these expenses decreased to 7.4% in the second quarter of 2003 as compared to 10.6% in the second quarter of 2002, and decreased to 8.1% in the first six months of 2003 as compared to 11.1% in the first six months of 2002.

## **Interest Expense**

Interest expense decreased 3.3% to \$424,336 in the second quarter of 2003 compared to \$438,638 in the second quarter of 2002, and decreased 8.7% to \$803,797 for the first six months of 2003 compared to \$880,599 for the first six months of 2002. The decreases reflected the repayment of the Crestmark Bank note in February 2002 and a lower variable interest rate on the loan from United Bank and Trust Company. As a percentage of revenues, interest expense increased to 11.9% in the second quarter of 2003 from 10.7% in the second quarter of 2002, and increased to 10.7% in the first six months of 2003 as compared to 10.4% in the first six months of 2002.

## **Other Expense / Amortization of Financing Cost**

Other expense / amortization of financing cost includes miscellaneous income and amortization expense. These expenses were \$19,061 in the second quarter of 2003 as compared to \$96,380 in the second quarter of 2002, and \$37,609 for the first six months of 2003 as compared to \$197,486 for the first six months of 2002.

## **Liquidity and Capital Resources**

### *Overview*

We have not made any required debt service payments to Wayne County Employees Retirement System ( WCERS ) since September 2001. On February 1, 2003, the entire \$8,912,786 principal amount of the secured debt held by WCERS became due and payable. As of August 8, 2003, we had defaulted on approximately \$10.6 million of principal and interest payments to WCERS and \$650,000 of principal payments to holders of our convertible subordinated promissory notes. We cannot assure you that we will have sufficient financial resources to repay existing indebtedness or to continue operations.

We used approximately \$42,000 and approximately \$1.3 million in cash for operating activities during the first six months of 2003 and the first six months of 2002, respectively. We had working capital deficits of approximately \$20.5 million at June 29, 2003, and approximately \$16.4 million at June 30, 2002. During the first six months of 2003 and the first six months of 2002, we spent \$20,000 and \$571,000, respectively, for equipment. At the direction of WCERS, we have been making interest and principal payments to United Bank and Trust Company. We have been making interest only payments to the holders of our convertible subordinated promissory notes.

In general, we have experienced operating losses in each quarterly and annual period since inception. We incurred net losses of approximately \$0.7 million for the second quarter of 2003 and approximately \$0.6 million for the second quarter of 2002. As of June 29, 2003, we had an accumulated deficit of \$14.7 million. We currently depend upon our existing units for all of our revenues. We expect to incur significant losses for the foreseeable future. We will need to generate significant increases in our revenues to achieve and maintain profitability. If our revenues fail to grow or grow more slowly than we anticipate, or our operating expenses exceed our expectations, our losses could significantly increase, which would harm our business, operating results, cash flows and financial condition. In addition, our failure to become and remain profitable may adversely affect the market price of our securities and our ability to raise capital and continue operations. The reports of our independent public accountants for the years ended December 29, 2002 and December 30, 2001 include explanatory paragraphs expressing doubt about our

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ability to continue as a going concern. In addition, our securities were delisted from The Nasdaq SmallCap Market on October 7, 2002, which may adversely affect our ability to raise capital.

Since inception, our principal capital requirements have been the funding of (a) our operations and promotion of the Big Buck Brewery & Steakhouse format and (b) the construction of units and the acquisition of furniture, fixtures and equipment for such units. Total capital expenditures for the Gaylord, Grand Rapids

and Auburn Hills units were approximately \$6.2 million, \$3.2 million and \$10.2 million, respectively. Total capital expenditures of Buck & Bass for the Grapevine unit were approximately \$7.6 million. Pursuant to our joint venture agreement with Bass Pro, we funded approximately \$6.4 million of that cost, including our \$1.5 million loan to Buck & Bass.

*Financing activities*

We did not raise funds through financing activities in the first six months of 2003. In February 2002, we received a \$500,000 advance from WCERS to cover unpaid real estate taxes in Michigan. In March 2002, we obtained a loan from United Bank and Trust Company for \$5,000,000 which matures in March 2004. The collateral of this loan is a \$5,000,000 letter of credit from WCERS. Of the proceeds of such loan, we had used approximately \$4,211,500 through August 8, 2003, for the following purposes:

\$200,000 to terminate our lease of the Nashville site,

\$500,000 to repay the advance from WCERS,

\$1,000,000 to repay our indebtedness to Crestmark Bank,

\$825,000 to settle the dispute between Buck & Bass and the general contractor of the Grapevine unit,

\$466,500 to make principal and interest payments to United Bank and Trust Company,

\$108,000 to pay Columbia Construction Services, an entity controlled by one of our directors, Mark S. Provenzano, for services rendered in connection with the Nashville site,

\$163,000 to pay certain accounts payable,

\$273,000 to pay property taxes, and

\$676,000 for other working capital purposes.

*Additional financing is required for debt repayment*

Without additional financing, our leveraged position, requirements for payments to the holders of our secured and subordinated debt and requirements for payments on our loan agreement may require us to liquidate all or a portion of our assets. We had working capital deficits of approximately \$20.5 million at June 29, 2003 and approximately \$16.4 million at June 30, 2002. As of August 8, 2003, we had outstanding (1) convertible secured debt aggregating \$7,412,786, (2) non-convertible secured debt aggregating \$5,360,188, and (3) convertible subordinated debt aggregating \$650,000. The outstanding convertible secured debt and \$1.5 million of the outstanding non-convertible secured debt matured on February 1, 2003. Of the outstanding convertible subordinated debt, \$100,000 matured in November 2000, \$300,000 matured in October 2001, \$50,000 matured in January 2002, \$100,000 matured in July 2002 and \$100,000 matured in December 2002. Our outstanding debt must be repaid in full as follows:

Type of Debt		Principal Amount	Repayment Required
Convertible Secured Debt	\$	7,412,786	Immediate
Non-Convertible Secured Debt	\$	1,500,000	Immediate
Non-Convertible Secured Debt	\$	3,860,188	March 2004
Convertible Subordinated Debt	\$	650,000	Immediate



To fund the maturity of our outstanding debt, we must obtain additional financing or refinance the debt. However, we cannot assure you that we will be able to obtain the required funds or refinance the debt, which could materially adversely affect our business, operating results, cash flows and financial condition.

*WCERS payment defaults and covenant violations*

We have not made any required debt service payments to WCERS since September 2001. On February 1, 2003, the entire \$8,912,786 principal amount of the secured debt held by WCERS became due and payable. As of August 8, 2003, we had defaulted on approximately \$10.6 million of principal and interest payments to WCERS. We cannot assure you that we will have sufficient financial resources to repay existing indebtedness or to continue operations.

Among other things, we agreed with WCERS that (1) we would not create, incur or suffer to be created or incurred or to exist, any lien of any kind upon any of our property or assets of any character whether then owned or thereafter acquired, or upon the income or profits therefrom except for certain permitted liens, (2) we would keep and maintain tangible net worth plus subordinated debt in an amount not less than \$8.5 million, (3) we would keep and maintain a minimum debt coverage ratio of 1.25 to 1.0 (excluding Grapevine pre-opening and financing costs), (4) we would maintain our then current cash flow position, and (5) we would not permit the difference between our current assets and our current liabilities (other than subordinated debt) to be less than \$500,000. We have notified WCERS that we have violated each of the foregoing covenants. On April 3, 2001, we entered into a letter agreement with WCERS pursuant to which the foregoing covenants were modified to provide that (1) we must maintain tangible net worth plus subordinated debt in an amount not less than \$6.25 million and (2) we had until January 1, 2002 to meet all other covenants set forth in the loan documents (unless modified by the parties in writing). We have notified WCERS that we have violated each of the foregoing covenants. On April 1, 2002, we entered into a letter agreement with WCERS pursuant to which the foregoing covenants were modified to provide that (1) we must maintain tangible net worth plus subordinated debt in an amount not less than \$4.5 million and (2) we had until January 1, 2003 to meet all other covenants set forth in the loan documents (unless modified by the parties in writing). We have notified WCERS that we have violated each of the foregoing covenants.

Because we have not made timely payments of principal and interest on our indebtedness to WCERS and are in violation of various covenants, we are in default under our agreements with WCERS. As a result, WCERS may, by notice in writing to us, declare all amounts owing with respect to the agreements to be immediately due and payable without presentment, demand, protest or other notice of any kind, all of which we previously waived. Our assets are, as a consequence, subject to foreclosure by WCERS. Foreclosure by WCERS would force us to cease all operations. We cannot assure you that we will be able to repay or refinance our indebtedness to WCERS or regain compliance with the amended covenants.

*Grapevine covenant violations*

The failure of Buck & Bass to achieve the required gross sales, the existence in the past of encumbrances upon the subleased premises and the failure of Buck & Bass to perform quarterly customer satisfaction surveys give Bass Pro the ability to declare an event of default under the sublease, terminate the sublease and demand all unpaid and reasonably calculable future rent over the balance of the sublease term. Pursuant to the limited partnership agreement, a material default under the sublease would also entitle Bass Pro to purchase our interest in the joint venture at 40% of book value, thereby eliminating our interest in the Grapevine unit. The termination of the sublease or the elimination of our interest in the Grapevine unit would have a material adverse effect on our business, operating results, cash flows and financial condition.



*Site repurchase obligations*

Because annual gross sales did not exceed \$1.5 million for the lease year ended April 2003, the lessor of the Grand Rapids unit obtained the right to require us to repurchase such site for \$1.4 million, plus \$70,000 for each lease year on a pro rata basis.

Because annual gross sales did not exceed \$8.0 million for the fourth and fifth years of the lease term, the lessor of the Auburn Hills unit obtained the right to require us to repurchase such site for \$4.0 million, plus \$200,000 for each lease year on a pro rata basis.

If either lessor elects to exercise his option to require us to repurchase a site, we would be forced to repurchase such site at a premium over its sale price. We cannot assure you that we will have sufficient funds to repurchase either site. If we are required to repurchase a site and cannot do so, it would have a material adverse impact on our business, operating results, cash flows and financial condition.

*Limitations on ability to incur additional indebtedness*

We granted the following security interests to WCERS in connection with its provision of certain debt financing:

a pledge of our limited partnership interest in Buck & Bass,

a pledge of our shares of the issued and outstanding common stock of BBBP Management  
Company, and

a security interest, assignment or mortgage, as applicable, in our interest in all assets now or hereafter owned, ownership interests, licenses, and permits, including, without limitation, a mortgage encumbering the Gaylord, Auburn Hills and Grand Rapids sites.

We also granted to WCERS a right of first refusal pursuant to which WCERS may, for so long as the approximately \$5.8 million promissory note is outstanding or WCERS owns more than 15% of our common stock, elect to purchase securities offered by us, within 45 days of the receipt of notice by WCERS, at the same price and on the same terms and conditions as are offered to a third party.

Our agreement with WCERS imposes limitations on our ability to incur additional indebtedness. We agreed that we would not create, incur, assume, guarantee or be or remain liable, contingently or otherwise, with respect to any indebtedness, except for indebtedness incurred in the ordinary course of business not to exceed at any time \$1.5 million in the aggregate. Any indebtedness not in the ordinary course of business or

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in excess of \$1.5 million requires the approval of WCERS. These restrictions may impede our ability to secure financing for continued operations. Our failure to raise capital when needed would have a material adverse effect on our business, operating results, cash flows and financial condition.

### *Liquidity plans*

We seek to refinance our indebtedness to WCERS. We hope to refinance such indebtedness at lower interest rates. We also plan to continue searching for ways of reducing our operating costs, including reduced general and administrative expenses.

### **Seasonality**

Our operating results are expected to fluctuate based on seasonal patterns. Based on our existing units, we anticipate that our highest revenues will occur in the second and third calendar quarters due to the milder climate during those quarters in Michigan. Because of the effect of seasonality on our business, results

for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year and cannot be used to indicate financial performance for a full fiscal year.

### **Cautionary Statement**

*Big Buck Brewery & Steakhouse, Inc., or persons acting on our behalf, or outside reviewers retained by us making statements on our behalf, or underwriters of our securities, from time to time, may make, in writing or orally, forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. This Cautionary Statement, when used in conjunction with an identified forward-looking statement, is for the purpose of qualifying for the safe harbor provisions of the Litigation Reform Act and is intended to be a readily available written document that contains factors which could cause results to differ materially from such forward-looking statements. These factors are in addition to any other cautionary statements, written or oral, which may be made, or referred to, in connection with any such forward-looking statement.*

*The following matters, among others, may have a material adverse effect on our business, financial condition, liquidity, results of operations or prospects, financial or otherwise. Reference to this Cautionary Statement in the context of a forward-looking statement or statements shall be deemed to be a statement that any one or more of the following factors may cause actual results to differ materially from those in such forward-looking statement or statements.*

**We may be unable to repay current maturities of existing indebtedness, forcing us to liquidate all or a portion of our assets.**

#### *Overview*

Without additional financing, our leveraged position, requirements for payments to the holders of our secured and subordinated debt and requirements for payments on our loan agreement may require us to liquidate all or a portion of our assets. We had working capital deficits of approximately \$20.5 million at June 29, 2003, and approximately \$16.4 million at June 30, 2002. As of August 8, 2003, we had outstanding (1) convertible secured debt aggregating \$7,412,786, (2) non-convertible secured debt aggregating \$5,360,188, and (3) convertible subordinated debt aggregating \$650,000. The outstanding convertible secured debt and \$1.5 million of the outstanding non-convertible secured debt matured on February 1, 2003. Of the outstanding convertible subordinated debt, \$100,000 matured in November 2000, \$300,000 matured in October 2001, \$50,000 matured in January 2002, \$100,000 matured in July 2002 and \$100,000 matured in December 2002.

To fund the maturity of the outstanding debt, we must obtain additional financing or refinance the debt. However, we cannot assure you that we will be able to obtain the required funds or refinance the debt, which could materially adversely affect our business, operating results, cash flows and financial condition.

*Convertible Secured and Non-Convertible Secured Debt*

We have not made any required debt service payments to WCERS since September 2001. On February 1, 2003, the entire \$8,912,786 principal amount of the secured debt held by WCERS became due and payable. As of August 8, 2003, we had defaulted on approximately \$10.6 million of principal and interest payments to WCERS. We cannot assure you that we will have sufficient financial resources to repay existing indebtedness or to continue operations. As of August 8, 2003, we were also in violation of various covenants under our agreements with WCERS.

Because we have not made timely payments of principal and interest on our indebtedness to WCERS and are in violation of various covenants, we are in default under our agreements with WCERS. As a result, WCERS may, by notice in writing to us, declare all amounts owing with respect to the agreements to be immediately due and payable without presentment, demand, protest or other notice of any kind, all of which we previously waived. Our assets are, as a consequence, subject to foreclosure by WCERS. Foreclosure by

WCERS would force us to cease all operations. We cannot assure you that we will be able to repay or refinance our indebtedness to WCERS or regain compliance with the amended covenants.

In March 2002, we obtained a loan from United Bank and Trust Company for \$5.0 million which matures in March 2004. The collateral of this loan is a \$5.0 million letter of credit from WCERS. We cannot assure you that we will be able to repay our indebtedness to United Bank.

#### *Convertible Subordinated Promissory Notes*

To fund the maturity of the outstanding convertible subordinated promissory notes, we must obtain additional financing or refinance the debt. However, we cannot assure you that we will be able to obtain the required funds or refinance the debt, which could materially adversely affect our business, operating results, cash flows and financial condition. As of August 8, 2003, our outstanding convertible subordinated promissory notes had the following terms and conditions:

Principal Amount	Date of Issuance	Maturity Date	Shares Issuable Upon Conversion	Conversion Price
\$ 100,000	10-08-99	10-07-01	9,523	\$ 10.5000
\$ 100,000	11-17-99	11-01-00	5,890	\$ 16.9764
\$ 100,000	01-19-00	10-01-01	14,285	\$ 7.0000
\$ 100,000	12-04-00	10-01-01	14,285	\$ 7.0000
\$ 50,000	01-27-00	01-01-02	9,784	\$ 5.1100
\$ 100,000	07-20-01	07-20-02	16,496	\$ 6.0620
\$ 100,000	12-11-01	12-11-02	27,793	\$ 3.5980

Because we have not made timely payments of principal on this indebtedness, the note holders may declare all amounts owing to be immediately due and payable without presentment, demand, protest or other notice of any kind, all of which we previously waived. We cannot assure you that we will be able to repay or refinance this indebtedness.

**We have incurred losses and we expect to incur substantial future losses. This may prevent us from raising capital and continuing operations.**

In general, we have experienced operating losses in each quarterly and annual period since inception. We incurred net losses of approximately \$0.7 million for the second quarter of 2003 and approximately \$0.6 million for the second quarter of 2002. As of June 29, 2003, we had an accumulated deficit of \$14.7 million. We currently depend upon our existing units for all of our revenues. We expect to incur significant losses for the foreseeable future. We will need to generate significant increases in our revenues to achieve and maintain profitability. If our revenues fail to grow or grow more slowly than we anticipate, or our operating expenses exceed our expectations, our losses could significantly increase, which would harm our business, operating results, cash flows and financial condition. In addition, our failure to become and remain profitable may adversely affect the market price of our securities and our ability to raise capital and continue operations. The reports

of our independent public accountants for the years ended December 29, 2002 and December 30, 2001 include explanatory paragraphs expressing doubt about our ability to continue as a going concern.

**If we are unable to obtain additional capital or secure refinancing, we may be required to scale back or cease operations.**

If additional capital does not become available to us, we may be required to scale back or cease operations. We cannot assure you that we will be able to secure additional financing or refinancing. If we are able to obtain financing or refinancing, we cannot assure you that it will be on favorable or acceptable terms. To obtain additional financing, we anticipate that we will be required to sell additional debt or equity



securities. New investors may seek and obtain substantially better terms than those available in connection with open market purchases and our issuance of securities in the future may result in substantial dilution. To obtain refinancing, we may be required to agree to certain negative covenants with which we may be unable to comply. In addition, our securities were delisted from The Nasdaq SmallCap Market on October 7, 2002, which may adversely affect our ability to raise capital.

Our agreement with WCERS imposes limitations on our ability to incur additional indebtedness. We agreed that we would not create, incur, assume, guarantee or be or remain liable, contingently or otherwise, with respect to any indebtedness, except for indebtedness incurred in the ordinary course of business not to exceed at any time \$1.5 million in the aggregate. Any indebtedness not in the ordinary course of business or in excess of \$1.5 million requires the approval of WCERS. We also granted to WCERS a right of first refusal pursuant to which WCERS may, for so long as the approximately \$5.8 million promissory note is outstanding or WCERS owns more than 15% of our common stock, elect to purchase securities offered by us, within 45 days of the receipt of notice by WCERS, at the same price and on the same terms and conditions as are offered to a third party. These restrictions may impede our ability to secure financing for continued operations. Our failure to raise capital when needed would have a material adverse effect on our business, operating results, cash flows and financial condition.

**We cannot assure you that future operations of any unit will be profitable.**

Future revenues and profits, if any, will depend upon various factors, including:

the quality of restaurant and brewery operations,

the acceptance of our food and beer, and

general economic conditions.

We cannot assure you that we will ever operate profitably.

**You may have difficulty reselling your securities.**

Our securities are subject to certain rules of the SEC relating to penny stocks. Such rules require broker-dealers to make a suitability determination for purchasers and to receive the purchaser's prior written consent for a purchase transaction, thus restricting the ability to purchase or sell the securities in the open market. In addition, trading in our securities is conducted in the over-the-counter market on the OTC Bulletin Board, which was established for securities that do not meet Nasdaq listing requirements. Selling our securities may be difficult because of the quantity of securities that may be bought and sold, the possibility that transactions may be delayed, and the low level of security analyst and

news media coverage given to over-the-counter stocks. These factors could contribute to lower prices and larger spreads in the bid and asked prices for our securities.

**Our interest in the Grapevine unit may be reduced or eliminated by Bass Pro.**

The failure of Buck & Bass to achieve the required gross sales, the existence in the past of encumbrances upon the subleased premises and the failure of Buck & Bass to perform quarterly customer satisfaction surveys give Bass Pro the ability to declare an event of default under the sublease, terminate the sublease and demand all unpaid and reasonably calculable future rent over the balance of the sublease term. Pursuant to the limited partnership agreement, a material default under the sublease would also entitle Bass Pro to purchase our interest in the joint venture at 40% of book value, thereby eliminating our interest in the Grapevine unit. The termination of the sublease or the elimination of our interest in the Grapevine unit would have a material adverse effect on our business, operating results, cash flows and financial condition.

**If Buck & Bass is required to pay more than the minimum annual base rent for the Grapevine site, funds available to us for other purposes will be reduced.**

Pursuant to a commercial sublease agreement, Buck & Bass leases the Grapevine site from Bass Pro over a 15-year term. Buck & Bass is obligated to pay annual percentage rent in the amount of 5.5% on gross sales less than \$11.0 million per year and 6.5% on gross sales in excess of \$11.0 million per year; provided, however, that the minimum annual base rent is \$385,000. Bass Pro may terminate the sublease in the event of a default which is not cured within the applicable grace period. In March 2000, we agreed with Bass Pro in writing to revise the definition of default under the sublease. As amended, the sublease provides that a default includes, but is not limited to:

the failure of Buck & Bass to remain open during all business days,

the failure of Buck & Bass to maintain on duty a fully trained service staff,

the failure of Buck & Bass to provide high quality food of the type provided at our Gaylord unit,

the failure of Buck & Bass to achieve gross sales in the first full calendar year immediately following the opening and for each calendar year thereafter of \$7.0 million,

Buck & Bass encumbering in any manner any interest in the subleased premises, or

the failure of Buck & Bass to conduct full and complete customer surveys no less frequently than each calendar quarter.

The minimum annual base rent is required whether the Grapevine unit is profitable or not. If Buck & Bass is required to pay in excess of the minimum annual base rent, the funds available to us for other purposes will be reduced. In the event of a default and termination of the joint venture agreement, our interest in the Grapevine unit would be eliminated. This would have a material adverse effect on our business, operating results, cash flows and financial condition.

**If we are required to pay more than the minimum annual base rent for the Grand Rapids or Auburn Hills sites, funds available to us for other purposes will be reduced.**

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In April 1997, we sold the Grand Rapids site, including all improvements thereto, to an entity owned by one of our shareholders, Eyde Brothers Development Co., pursuant to a real estate purchase and leaseback agreement for \$1.4 million. Pursuant to a separate lease agreement, we lease the Grand Rapids site at a minimum annual base rent of \$140,000 and a maximum annual base rent of \$192,500 over a ten-year term. The lease may be extended at our option for up to two additional five-year terms. In addition to the annual base rent, the lease, as amended in March 2000, provides that we are obligated to pay annual percentage rent in the amount of 5% on gross sales at the site in excess of \$1.5 million per year.

In August 1997, we entered into a real estate purchase and leaseback agreement providing for the sale of the Auburn Hills site to one of our shareholders, Michael G. Eyde, for \$4.0 million. We lease the Auburn Hills site pursuant to a separate lease agreement which provides for a minimum annual base rent of \$400,000, and a maximum annual base rent of \$550,000, over a 25-year term. The lease may be extended at our option for up to two additional ten-year terms. In addition to the annual base rent, we are obligated to pay annual percentage rent of 5.25% of gross sales at the site in excess of \$8.0 million per year.

Annual percentage rent is required whether or not such units are profitable. If we are required to pay annual percentage rent, the funds available to us for other purposes will be reduced.

**If we default and the lessor of the Grand Rapids site or the lessor of the Auburn Hills site terminates the related lease, we would be unable to continue operating such unit.**

The Grand Rapids and Auburn Hills lessors may terminate in the event of a default which is not cured within the applicable grace period. A default is defined as:

our failure to make a rental payment within 30 days after receipt of written notice that a payment is past due, or

our failure to perform our obligations under the lease, other than rent payments, within 30 days after written notice of a curable violation;

provided, however, that if such default cannot be cured within the 30-day period, a default will be deemed to have occurred only if we have failed to commence a cure within such 30-day period. In the event of a default and termination of either lease, we would be unable to continue operating the related unit, which would have a material adverse effect on our business, operating results, cash flows and financial condition.

**If we are required to repurchase the Grand Rapids site or the Auburn Hills site and cannot do so, we would be unable to continue operating such unit.**

Because annual gross sales did not exceed \$1.5 million for the lease year ended April 2003, the lessor of the Grand Rapids unit obtained the right to require us to repurchase such site for \$1.4 million, plus \$70,000 for each lease year on a pro rata basis.

Because annual gross sales did not exceed \$8.0 million for the fourth and fifth years of the lease term, the lessor of the Auburn Hills unit obtained the right to require us to repurchase such site for \$4.0 million, plus \$200,000 for each lease year on a pro rata basis.

If either lessor elects to exercise its option to require us to repurchase a site, we would be forced to repurchase such site at a premium over its sale price. We cannot assure you that we will have sufficient funds to repurchase either site. If we are required to repurchase a site and cannot do so, it would have a material adverse impact on our business, operating results, cash flows and financial condition.

**We may be unable to compete with larger, better-established restaurant competitors.**

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The restaurant industry is highly competitive with respect to price, service, location and food quality, including taste, freshness and nutritional value. New restaurants have a high failure rate. New restaurants generally experience a decline in revenue growth, or in actual revenues, following a period of excitement that accompanies their opening. The restaurant industry is also generally affected by changes in consumer preferences, national, regional and local economic conditions, and demographic trends. The performance of individual restaurants may also be affected by factors such as traffic patterns, demographic considerations, and the type, number and location of competing restaurants. In addition, factors such as inflation, increased food, labor and employee benefit costs, and the unavailability of experienced management and hourly employees may also adversely affect the restaurant industry in general and our units in particular. Restaurant operating costs are further affected by increases in the minimum hourly wage, unemployment tax rates and similar matters over which we have no control. We face numerous well-established competitors, including national, regional and local restaurant chains, possessing substantially greater financial, marketing, personnel and other resources than we do. We also compete with a large variety of locally owned restaurants, diners and other establishments that offer moderately priced food to the public and with other brewpubs. Competitors could utilize the Big Buck Brewery & Steakhouse format or a related format. We cannot assure you that we will be able to respond to various competitive factors affecting the restaurant industry.

**If we are unable to comply with applicable restaurant regulations, we will be unable to operate; compliance with such regulations may increase our operating expenses.**

The restaurant industry is subject to numerous federal, state and local government regulations, including those relating to the preparation and sale of food and those relating to building and zoning requirements. We are subject to regulation by air and water pollution control divisions of the Environmental Protection Agency of the United States and by certain states and municipalities in which our units are located. We are also subject to laws governing our relationship with our employees, including minimum wage requirements, overtime, working and safety conditions and citizenship requirements. Restaurant operating costs are affected by increases in the minimum hourly wage, unemployment tax rates, sales taxes and similar matters, such as any government-mandated health insurance, over which we have no control.

**Our operations depend upon obtaining and maintaining governmental licenses and permits required for brewing and selling beer.**

A significant percentage of our revenue is derived from beer sales. Total sales of alcohol, including beer, wine and hard liquor, accounted for 22.1% of our revenues during the second quarter of 2003. We must comply with federal licensing requirements imposed by the United States Department of Treasury, Alcohol and Tobacco Tax and Trade Bureau, as well as the licensing requirements of states and municipalities where our units are located. Our failure to comply with federal, state or local regulations could cause our licenses to be revoked and force us to cease brewing and selling our beer. Typically, licenses must be renewed annually and may be revoked or suspended for cause at any time.

**We may face liability under dram-shop laws.**

We are subject to dram-shop laws in Michigan and Texas. These laws generally provide someone injured by an intoxicated person the right to recover damages from the establishment that wrongfully served alcoholic beverages to such person. We carry liquor liability coverage as part of our existing comprehensive general liability insurance. However, a judgment against us under a dram-shop statute in excess of our liability coverage could have a material adverse effect on our business, operating results, cash flows and financial condition.

**We must pay federal and state excise taxes on our beer; we may be unable to retain the credits that help us to offset part of such taxes.**

The federal government currently imposes an excise tax of \$18.00 on each barrel of beer produced for domestic consumption in the United States. However, each brewer with production of not more than 2,000,000 barrels per year is taxed only \$7.00 per barrel on the first 60,000 barrels produced annually. We cannot assure you that the federal government will not reduce or eliminate this small brewer rate reduction. Michigan imposes an excise tax of \$6.30 per barrel on each barrel of beer manufactured or sold in Michigan. However, each brewer that manufactures less than 50,000 barrels per year is granted a brewer's excise tax credit in the amount of \$2.00 per barrel for the first 30,000 barrels. Buck & Bass is subject to excise taxes under Texas law. Excise taxes in Texas are \$6.138 per barrel for ale and malt liquor, and \$6.00 per barrel for beer. However, Texas grants a 25% tax exemption for manufacturers of beer whose annual production in Texas does not exceed 75,000 barrels of beer per year. As a result, Buck & Bass faces an effective excise tax of \$4.50 per barrel for beer. If our beer production exceeds the foregoing credit thresholds, our average excise tax rate would increase.

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It is possible that the rate of excise taxation could be increased by either federal or state governments, or both. Increased excise taxes on alcoholic beverages have been considered by the federal government as an additional source of tax revenue in connection with various proposals and could be included in future legislation. Future increases in excise taxes on alcoholic beverages, if enacted, could adversely affect our business, operating results, cash flows and financial condition.



**Our management possesses significant control which could reduce your ability to receive a premium for your securities through a change in control.**

As of August 8, 2003, our officers and directors beneficially owned approximately 45.5% of our outstanding common stock. Accordingly, such persons, if they act in concert, can:

exert substantial influence over the composition of our board of directors,

generally direct our affairs, and

generally control the outcome of shareholder approvals of business acquisitions, mergers and combinations and other actions.

We are also subject to Michigan statutes regulating business combinations and restricting voting rights of certain persons acquiring shares of common stock which may hinder or delay a change in control.

**Fluctuations in our operating results may result in decreases in the market price of our securities.**

Our sales and earnings are expected to fluctuate based on seasonal patterns. Based on our existing units, we anticipate that our highest earnings will occur in the second and third calendar quarters due to the milder climate during those quarters in Michigan. Because of the effect of seasonality on our business, results for any quarter are not necessarily indicative of the results for a full fiscal year.

**You may not be able to sell our securities at the same price at which you purchase our securities due to significant volatility in the market price of our securities.**

The market price of our common stock has been subject to significant fluctuations in response to numerous factors, including:

variations in our annual or quarterly financial results or those of our competitors,

conditions in the economy in general or in the brewing industry in particular,

unfavorable publicity, and

changes in applicable laws and regulations, or judicial or administrative interpretations thereof, affecting us or the brewing industry.

We cannot assure purchasers of our securities that they will be able to sell such securities at or above the prices at which they were purchased. In addition, our securities were delisted from The Nasdaq SmallCap Market on October 7, 2002, which may adversely affect the liquidity of our securities.

**The sale of additional securities may be dilutive to existing security holders.**

We had 861,997 shares of common stock outstanding as of August 8, 2003. On that date, we also had warrants, stock options, convertible debt and other rights outstanding to purchase an additional 837,946 shares of common stock, exercisable at prices ranging from \$0.28 to \$36.75 per share. We have also registered certain shares of our common stock for resale on the public market. The sale of such shares, and the sale of additional shares which may become eligible for sale in the public market from time to time upon the exercise of warrants, stock options, convertible debt and other rights, may be dilutive to existing security holders and could have the effect of depressing the market price of our securities.

ITEM 3                      Controls and Procedures

We maintain a system of disclosure controls and procedures that is designed to provide reasonable assurance that information, which is required to be disclosed, is accumulated and communicated to management timely. Within the 90-day period prior to the filing date of this periodic report, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer (who also serves as our Chief Financial Officer), of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, our Chief Executive Officer concluded that our disclosure controls and procedures are effective in timely alerting him to material information relating to our company required to be disclosed in our periodic filings with the SEC.

There were no significant changes in our internal controls or in other factors that could significantly affect our internal controls subsequent to the date of their most recent evaluation.

**PART II**                                      **OTHER INFORMATION**

ITEM 1                                      Legal Proceedings

We were not a party to any material litigation as of August 8, 2003.

ITEM 2                                      Changes in Securities and Use of Proceeds

Not applicable.

ITEM 3                                      Defaults upon Senior Securities

We have not made any required debt service payments to Wayne County Employees Retirement System ( WCERS ) since September 2001. On February 1, 2003, the entire \$8,912,786 principal amount of secured debt held by WCERS became due and payable. As of August 8, 2003, we had defaulted on approximately \$10.6 million of principal and interest payments to WCERS and \$650,000 of principal payments to holders of our convertible subordinated promissory notes.

Because we have not made timely payments of principal and interest on our indebtedness to WCERS and are in violation of various covenants, we are in default under our agreements with WCERS. As a result, WCERS may, by notice in writing to us, declare all amounts owing with respect to the agreements to be immediately due and payable without presentment, demand, protest or other notice of any kind, all of which we previously waived. Our assets are, as a consequence, subject to foreclosure by WCERS. Foreclosure by WCERS would force us to cease all operations. We cannot assure you that we will be able to repay or refinance our indebtedness to WCERS or regain compliance with the amended covenants.

For more information regarding our payment and other defaults, please review Management s Discussion and Analysis or Plan of Operation Liquidity and Capital Resources.

ITEM 4                                      Submission of Matters to a Vote of Security Holders

Not applicable.

ITEM 5 Other Information

Not applicable.

ITEM 6 Exhibits and Reports on Form 8-K

(a) Exhibits

See Index to Exhibits.

(b) Reports on Form 8-K

The registrant filed no Current Reports on Form 8-K during the second quarter of 2003.

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BIG BUCK BREWERY & STEAKHOUSE, INC.

Date: August 12, 2003

By

/s/ Anthony P. Dombrowski  
Anthony P. Dombrowski  
President, Chief Executive Officer,  
Chief Financial Officer and Treasurer

**INDEX TO EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
31	Certification Pursuant to Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.