FIRST MID ILLINOIS BANCSHARES INC
Form 10-K
March 05, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018
Or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____________ to ______________

Commission file number 0-13368
FIRST MID-ILLINOIS BANCSHARES, INC.
(Exact name of Registrant as specified in its charter)

Delaware	37-1103704
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
1421 Charleston Avenue, Mattoon, Illinois	61938
(Address of principal executive offices)	(Zip code)

(217) 234-7454
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:
Common stock, par value $4.00 per share
(Title of class)
Securities registered pursuant to Section 12(g) of the Act:
NONE

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. [ ] Yes [X] No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. [ ] Yes [X] No

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

Indicate by check mark whether the Registrant has submitted electronically, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form Yes [x]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer”, "smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer [ ] Accelerated filer [X]
Non-accelerated filer [ ] Smaller reporting company [ ]
Emerging growth company [ ]
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

The aggregate market value of the outstanding common stock, other than shares held by persons who may be deemed affiliates of the Registrant, as of the last business day of the Registrant’s most recently completed second fiscal quarter was approximately $513,588,874. Determination of stock ownership by non-affiliates was made solely for the purpose of responding to this requirement and the Registrant is not bound by this determination for any other purpose.

As of March 5, 2019, 16,671,367 shares of the Registrant’s common stock, $4.00 par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Document	Into Form 10-K Part:
Portions of the Proxy Statement for 2019 Annual Meeting of Shareholders to be held on April 24, 2019	III

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PART I

ITEM 1. BUSINESS

Company and Subsidiaries

First Mid-Illinois Bancshares, Inc. (the "Company") is a financial holding company. The Company is engaged in the business of banking through its wholly owned subsidiaries, First Mid Bank & Trust, N.A. ("First Mid Bank") and Soy Capital Bank & Trust Company ("Soy Capital Bank"). The Company provides data processing services to affiliates through another wholly owned subsidiary, Mid-Illinois Data Services, Inc. ("MIDS"). The Company offers insurance products and services to customers through its wholly owned subsidiary, First Mid Insurance Group ("First Mid Insurance"). The Company offers trust, farm services, investment services, and retirement planning through its wholly owned subsidiary, First Mid Wealth Management Company. The Company also wholly owns four statutory business trusts, First Mid-Illinois Statutory Trust I ("First Mid Trust I"), and First Mid-Illinois Statutory Trust II ("First Mid Trust II"), Clover Leaf Statutory Trust I ("CLST Trust"), and FBTC Statutory Trust I ("FBTCST I"), all of which are unconsolidated subsidiaries of the Company.

The Company, a Delaware corporation, was incorporated on September 8, 1981, and pursuant to the approval of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") became the holding company owning all of the outstanding stock of First National Bank, Mattoon ("First National") on June 1, 1982. First National changed its name to First Mid-Illinois Bank & Trust, N.A. in 1992. The Company acquired all of the outstanding stock of a number of community banks or thrift institutions on the following dates, and subsequently combined their operations with those of the Company:

- Mattoon Bank, Mattoon on April 2, 1984
- State Bank of Sullivan on April 1, 1985
- Cumberland County National Bank in Neoga on December 31, 1985
- First National Bank and Trust Company of Douglas County on December 31, 1986
- Charleston Community Bank on December 30, 1987
- Heartland Federal Savings and Loan Association on July 1, 1992
- Downstate Bancshares, Inc. on October 4, 1994
- American Bank of Illinois on April 20, 2001
- Peoples State Bank of Mansfield on May 1, 2006
- First Clover Leaf Financial on September 8, 2016
- First BancTrust Corporation on August 10, 2018
- SCB Bancorp Inc. on November 15, 2018

In 1997, First Mid Bank acquired the Charleston, Illinois branch location and the customer base of First of America Bank and in 1999 acquired the Monticello, Taylorville and DeLand branch offices and deposit base of Bank One Illinois, N.A.

First Mid Bank also opened a de novo branch in Decatur, Illinois (2000); de novo branches in Champaign, Illinois and Maryville, Illinois (2002), a de novo branch in Highland, Illinois (2005) de novo branches in Decatur, Illinois and Champaign, Illinois (2009), and a de novo branch in Decatur, Illinois (2013).

In 2002, the Company acquired all of the outstanding stock of First Mid Insurance, an insurance agency located in Mattoon.

On September 10, 2010, First Mid Bank acquired 10 Illinois branches from First Bank, a Missouri state chartered bank, located in Bartonville, Bloomington, Galesburg, Knoxville, Peoria and Quincy, Illinois.

On August 14, 2015 First Mid Bank acquired 12 Illinois branch offices (the "ONB Branches") of Old National Bank in Southern Illinois, a national banking association having its principal office in Evansville, Indiana, located in Lawrenceville, Mt Carmel, Mt Vernon, Carmi, De Soto, Murphysboro, Marion, Harrisburg, Carterville and Carbondale, Illinois.

On December 1, 2015 FIrst Mid Insurance acquired Illiana Insurance Agency, LTD ("Illiana"), an insurance agency based in Philo, Illinois.

Employees

The Company and its subsidiaries collectively employed 818 people on a full-time equivalent basis as of December 31, 2018. The Company places a high priority on staff development, which involves extensive training, including customer service training. New employees are selected on the basis of experience, technical skills and customer service capabilities. None of the employees are covered by a collective bargaining agreement with the Company. The Company offers a variety of employee benefits.

Business Lines

The Company has chosen to operate in three primary lines of business—community banking through First Mid Bank and Soy Capital Bank, wealth management through First Mid Wealth Management Company, and insurance brokerage through First Mid Insurance. Of these, the community banking line contributes approximately 90% of the Company's total revenues. Within the community banking line, the Company serves commercial, retail and agricultural customers with a broad array of deposit and loan related products. The wealth management line provides estate planning, investment and farm management services for individuals and employee benefit services for business enterprises. The insurance brokerage line provides commercial lines insurance to businesses as well as homeowner, automobile, health, life and other types of personal lines insurance to individuals. All three lines emphasize a "hands on" approach to service so that products and services can be tailored to fit the specific needs of existing and potential customers. Management believes that by emphasizing this personalized approach, the Company can, to a degree, diminish the trend towards homogeneous financial services, thereby differentiating the Company from competitors and allowing for slightly higher operating margins in each of the three lines.

Business Strategies

Mission Statement. The Company's mission statement is to fulfill the financial needs of our communities with exceptional personal service, professionalism and integrity, and deliver meaningful value and results for customers and shareholders.
Achieve 2020. Achieve 2020 is a strategic plan that was developed in 2015. This multi-year strategic plan has broad-based initiatives designed to ensure the Company performs at a level with the highest performing community banks in the Midwest and to increase value for its shareholders, customers and employees in the future. The strategic plan was developed by executive management of the Company, modified and adopted by the Board of Directors and communicated to employees. The plan is reviewed and updated, if needed, annually. The Achieve 2020 plan was not undertaken as a result of any weaknesses or deficiencies identified during the Company's control assessments but rather as part of the Company's effort to continually assess and improve. Achieve 2020 is comprised of broad strategies that impact growth, customers, employees, and operations and infrastructure, shareholders and risk management. Following is a description of these strategies.
Growth Strategy. The Company believes that growth of revenues and its customer base is vital to the goal of increasing the value of its shareholders' investment. The Company strives to create shareholder value by maintaining a strong balance sheet and increasing profits. Management attempts to grow in two primary ways:
· by organic growth through adding new customers and selling more products and services to existing customers; and
· by strategic acquisitions.

Virtually all of the Company's customer-contact personnel, in each of its business lines, are engaged in organic growth efforts to one degree or another. These personnel attempt to match products and services with the particular financial needs of individual customers and prospective customers. Many senior officers of the organization are required to attend monthly meetings where they report on their business development efforts and results. Executive management uses these meetings as an educational and risk management opportunity as well. Cross-selling opportunities are encouraged and measured between the business lines and is facilitated by an on-line application.

Within the community banking line, the Company has focused on growing business operating and real estate loans. Total commercial real estate loans have increased from $380 million at December 31, 2014 to $907 million at December 31, 2018. Of this increase, approximately $20 million was the result of the acquisition of the ONB Branches in the third quarter of 2015 and $156 million was the result of the acquisition of First Clover Leaf in the third quarter of 2016, $55 million was the result of the acquisition of First Bank during the second quarter of 2018, and $50 million was the result of the acquisition of Soy Capital Bank during the fourth quarter of 2018.

Approximately 67% of the Company’s total revenues were derived from lending activities in the fiscal year ended December 31, 2018. The Company has also focused on growing its commercial and retail deposit base through growth in checking, money markets and customer repurchase agreement balances. The wealth management line has focused its growth efforts on estate planning, and investment services for individuals and employee benefit services for businesses. The insurance brokerage line has focused on increasing property and casualty, senior insurance products and group medical insurance for businesses and personal lines insurance to individuals.

Growth through acquisitions has been an integral part of the Company’s strategy for an extended period of time. When reviewing acquisition possibilities, the Company focuses on those organizations where there is a cultural fit with its existing operations and where there is a strong likelihood of building shareholder value.

Customer Strategy. The Company uses its market and customer knowledge to build relationships that provide high-value customer experiences that continually improve customer satisfaction and loyalty.

Employee Strategy. The Company strives for employee engagement at all levels of the organization. The judgments, experiences and capabilities of these employees are used to create an environment where meeting the needs of our customer, communities and stockholders is always a priority.

Strategy for Operations & Infrastructure. Operationally, the Company centralizes most administrative and operational tasks within its home office in Mattoon, Illinois. This allows branches to maintain customer focus, helps assure compliance with banking regulations, keeps fixed administrative costs at as low a level as practicable, and allows for better management of risk inherent in the business. The Company also utilizes technology where practicable in daily banking activities to reduce the potential for human error. While the Company does not employ every new technology that is introduced, it attempts to be competitive with other banking organizations with respect to operational and customer technology.

Shareholder Strategy. The Company strives to provide a competitive dividend as well as the opportunity for stock price appreciation and is focused on improving the liquidity of the stock.

Risk Management Strategy. The Company maintains a comprehensive risk management framework. The Company has initiated an Enterprise Risk Management (“ERM”) process whereby management assesses the relevant risks inherent in the business, determines internal controls and procedures are in place to address the various risks, develops a structure for monitoring and reporting risk indicators and trends over time, and incorporates action plans to manage risk positions. The ERM process was not undertaken as a result of any weaknesses or deficiencies identified during the Company’s control assessments but rather is part of the Company’s effort to continually assess and improve by taking a more holistic approach to risk management. The Company's Chief Risk Management Officer is responsible for facilitating the ERM process. The Company utilizes a comprehensive set of operational policies and procedures that have been developed over time. These policies are continually reviewed by management, the Chief Risk Management Officer, and the Board of Directors. The Company’s internal audit function completes procedures to ensure compliance with these policies. While there are several risks that pertain to the business of banking, three risks that are inherent with most banking companies are credit risk, interest rate risk, and liquidity risk.

In the business of banking, credit risk is an important risk as losses from uncollectible loans can diminish capital, earnings and shareholder value. In order to address this risk, the lending function of First Mid Bank and Soy Capital Bank receives significant oversight from executive management and the Board of Directors. An important element of credit risk management is the quality, experience and training of the loan officers. The Company has invested, and will continue to invest, significant resources to ensure the quality, experience and training of our loan officers in order to keep credit losses at a minimum. In addition to the human element of credit risk management, the Company’s loan policies address the additional aspects of credit risk. Most lending personnel have signature authority that allows them to lend up to a certain amount based on their own judgment as to the creditworthiness of a borrower. The amount of the signature authority is based on the lending officers’ experience and training. The Senior Loan Committee, consisting of the most experienced lenders within the organization, must approve all underwriting decisions in excess of $4 million and up to $15 million. The Board of Directors must approve all underwriting decisions in excess of $15 million. The legal lending limit for First Mid Bank was $52.6 million and Soy Capital Bank was $6.8 million at December 31, 2018. While the underlying nature of lending will result in some amount of loan losses, First Mid's loan loss experience has been good with average net charge offs amounting to $1.6 million (0.10% of total loans) over the past five years. Nonperforming loans were $39.8 million (1.51% of total loans) at December 31, 2018. These percentages have historically compared well with peer financial institutions and continue to do so today.

Interest rate and liquidity risk are two other forms of risk embedded in the banking business. The Company’s Asset Liability Management Committee, consisting of experienced individuals, from various departments, who monitor all aspects of interest rates and maturities of interest earning assets and interest paying liabilities, manages these risks. The underlying objectives of interest rate and liquidity risk management are to shelter the Company’s net interest margin from changes in interest rates while maintaining adequate liquidity reserves to meet unanticipated funding demands. The Company uses financial modeling technology as a tool for evaluating these risks. Despite the tools and methods used to monitor this risk, a sustained unfavorable interest rate environment will lead to some amount of compression in the net interest margin. During 2018, the Company’s net interest margin increased to 3.71% from 3.57% in 2017 primarily due to the increase interest earnings assets and net accretion income from the acquisition of First Clover Leaf.

Markets and Competition

The Company has active competition in all areas in which First Mid Bank and Soy Capital Bank do business. The banks compete for commercial and individual deposits, loans, and trust business with many east central Illinois banks, savings and loan associations, and credit unions. The principal methods of competition in the banking and financial services industry are quality of services to customers, ease of access to facilities, on-line services and pricing of services, including interest rates paid on deposits, interest rates charged on loans, and fees charged for fiduciary and other banking services.

During 2018, First Mid Bank and Soy Capital Bank operated branches in the Illinois counties of Adams, Champaign, Christian, Clark, Coles, Cumberland, Dewitt, Douglas, Edgar, Effingham, Jackson, Jefferson, Kankakee, Knox, Lawrence, Macon, Madison, Moultrie, McClean, Peoria, Piatt, Saline, St Clair, Wabash, White and Williamson and in Missouri, St. Louis county. Each branch primarily serves the community in which it is located. First Mid Bank served thirty-seven different communities with sixty-four separate locations in Illinois, 1 location in Missouri, and a loan production office in Indiana.

Website

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

First BancTrust Corporation

On December 11, 2017, the Company and Project Hawks Merger Sub LLC (formerly known as Project Hawks Merger Sub Corp.), a newly formed Delaware limited liability company and wholly-owned subsidiary of the Company ("Hawks Merger Sub"), entered into an Agreement and Plan of Merger (as amended as of January 18, 2018, the "First Bank Merger Agreement") with First BancTrust Corporation, a Delaware corporation ("First Bank"), pursuant to which, among other things, the Company agreed to acquire 100% of the issued and outstanding shares of First Bank pursuant to a business combination whereby First Bank merged with and into Hawks Merger Sub, with Hawks Merger Sub as the surviving entity and a wholly-owned subsidiary of the Company (the "First Bank Merger").

Subject to the terms and conditions of the First Bank Merger Agreement, at the effective time of the First Bank Merger, each share of common stock, par value $0.01 per share, of First Bank issued and outstanding immediately prior to the effective time of the First Bank Merger (other than shares held in treasury by First Bank and shares held by stockholders who have properly made and not withdrawn a demand for appraisal rights under Delaware law) converted into and become the right to receive, (a) $5.00 in cash and (b) 0.800 shares of common stock, par value $4.00 per share, of the Company and cash in lieu of fractional shares, less any applicable taxes required to be withheld and subject to certain adjustments, all as set forth in the First Bank Merger Agreement.

The First Bank Merger closed on May 1, 2018 and the Company issued an aggregate total of 1,643,900 shares of common stock and paid approximately $10,275,000, including cash in lieu of fractional shares. The accounting for the First Bank Merger is presented in Note 8 to the consolidated financial statements. First Bank's wholly-owned bank subsidiary, First Bank & Trust, merged with and into the Company's wholly owned bank subsidiary, First Mid Bank, on August 10, 2018. At the time of the bank merger, First Bank & Trust's banking offices became branches of First Mid Bank.

SCB Bancorp, Inc.

On June 12, 2018, The Company and Project Almond Merger Sub LLC, a newly formed Illinois limited liability company and wholly-owned subsidiary of the Company ("Almond Merger Sub"), entered into an Agreement and Plan of Merger (the "SCB Merger Agreement") with SCB Bancorp, Inc., an Illinois corporation ("SCB"), pursuant to which, among other things, the Company agreed to acquire 100% of the issued and outstanding shares of SCB pursuant to a business combination whereby SCB will merge with and into Almond Merger Sub, whereupon the separate corporate existence of SCB will cease and Merger Sub will continue as the surviving company and a wholly-owned subsidiary of the Company (the "SCB Merger").

Subject to the terms and conditions of the SCB Merger Agreement, at the effective time of the SCB Merger, each share of common stock, par value $7.50 per share, of SCB issued and outstanding immediately prior to the effective time of the SCB Merger were converted into and become the right to receive, at the election of each stockholder, either $307.93 in cash or 8.0228 shares of common stock, par value $4.00 per share, of the Company and cash in lieu of fractional shares, less any applicable taxes required to be withheld. In addition, immediately prior to the closing of the proposed merger, SCB paid a special dividend to its shareholders in the aggregate amount of approximately $25 million. The SCB Merger was subject to customary closing conditions, including the approval of the appropriate regulatory authorities and of the stockholders of SCB. The SCB Merger was completed November 15, 2018 and an aggregate of 1,330,571 shares of common stock were issued, and approximately $19,046,000 was paid, to the stockholders of SCB, including cash in lieu of fractional shares.

It is anticipated that SCB's wholly-owned bank subsidiary, Soy Capital Bank and Trust Company ("Soy Capital Bank"), will be merged with and into First Mid Bank on April 6, 2019. At the time of the bank merger, Soy Capital Bank's banking offices will become branches of First Mid Bank.

Capital Raise

On June 13, 2018, the Company and First Mid Bank entered into an underwriting agreement (the "Underwriting Agreement") with FIG Partners, LLC, as the representative of the several underwriters named therein (the "Underwriters"), pursuant to which the Company agreed to issue and sell to the Underwriters and the Underwriters agreed to purchase, subject to and upon the terms and conditions of the Underwriting Agreement, an aggregate of 823,799 shares of the Company's common stock, par value $4.00 per share, at a public offering price of $38.00 per share, in an underwritten public offering (the "Offering"). The Company granted the Underwriters an option for a period of 30 days after the date of the Underwriting Agreement to purchase up to an additional 123,569 shares of common stock at the public offering price, less discounts and commissions. The Underwriters exercised their option in full on June 13, 2018, resulting in 947,368 shares of common stock being offered in the Offering. The Offering closed on June 15, 2018. The net proceeds to the Company, after deducting underwriting discounts and commissions and offering expenses, were approximately $34.0 million.

At-The-Market Program

On August 16, 2017, the Company entered into a Sales Agency Agreement, pursuant to which the Company may sell, from time to time, up to an aggregate of $20 million of its common stock. Shares of common stock are offered pursuant to the Company's shelf registration statement filed within the SEC. During 2018, the company sold no shares of common stock under the program. During the twelve months ended December 31, 2017, the company sold 98,710 shares of common stock at the weighted average price of approximately $35.13, representing gross proceeds of $3.47 million and net proceeds of $3.4 million. As of December 31, 2018, approximately $16.53 million of common stock remained available for issuance under the At The Market program.

Employee Stock Purchase Plan

At the Annual Meeting of Stockholders held April 25, 2018, the stockholders approved the First Mid-Illinois Bancshares, Inc. Employee Stock Purchase Plan (“ESPP”). The ESPP provides eligible employees with the opportunity to purchase shares of common stock of the Company at a 5% discount through payroll deductions. The ESPP is intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code. A maximum of 600,000 shares of common stock may be issued under the ESPP.

Supervision and Regulation

General

Financial institutions, financial services companies, and their holding companies are extensively regulated under federal and state law. As a result, the growth and earnings performance of the Company can be affected not only by management decisions and general economic conditions, but also by the requirements of applicable state and federal statutes and regulations and the policies of various governmental regulatory authorities including, but not limited to, the Office of the Comptroller of the Currency (the “OCC”), the Federal Reserve Board, the Federal Deposit Insurance Corporation (the “FDIC”), the Internal Revenue Service and state taxing authorities. Any change in applicable laws, regulations or regulatory policies may have material effects on the business, operations and prospects of the Company, First Mid Bank, and Soy Capital Bank. The Company is unable to predict the nature or extent of the effects that fiscal or monetary policies, economic controls or new federal or state legislation may have on its business and earnings in the future.

Federal and state laws and regulations generally applicable to financial institutions and financial services companies, such as the Company and its subsidiaries, regulate, among other things, the scope of business, investments, reserves against deposits, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, mergers, consolidations and dividends. The system of supervision and regulation applicable to the Company and its subsidiaries establishes a comprehensive framework for their respective operations and is intended primarily for the protection of the FDIC's deposit insurance fund and the depositors, rather than the stockholders, of financial institutions.

The following references to material statutes and regulations affecting the Company and its subsidiaries are brief summaries thereof and do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations. Any change in applicable law or regulations may have a material effect on the business of the Company and its subsidiaries.

Financial Modernization Legislation

The 1999 Gramm-Leach-Bliley Act (the "GLB Act") significantly changed financial services regulation by expanding permissible non-banking activities of bank holding companies and removing certain barriers to affiliations among banks, insurance companies, securities firms and other financial services entities. These activities and affiliations can be structured through a holding company structure or, in the case of many of the activities, through a financial subsidiary of a bank. The GLB Act also established a system of federal and state regulation based on functional regulation, meaning that primary regulatory oversight for a particular activity generally resides with the federal or state regulator having the greatest expertise in the area. Banking is supervised by banking regulators, insurance by state insurance regulators and securities activities by the SEC and state securities regulators. The GLB Act also requires the disclosure of agreements reached with community groups that relate to the Community Reinvestment Act, and contains various other provisions designed to improve the delivery of financial services to consumers while maintaining an appropriate level of safety in the financial services industry.

The GLB Act repealed the anti-affiliation provisions of the Glass-Steagall Act and revised the Bank Holding Company Act of 1956 (the "BHCA") to permit qualifying holding companies, called "financial holding companies," to engage in, or to affiliate with companies engaged in, a full range of financial activities, including banking, insurance activities (including insurance portfolio investing), securities activities, merchant banking and additional activities that are "financial in nature," incidental to financial activities or, in certain circumstances, complementary to financial activities. A bank holding company's subsidiary banks must be "well-capitalized" and "well-managed" and have at least a "satisfactory" Community Reinvestment Act rating for the bank holding company to elect and maintain its status as a financial holding company.

A significant component of the GLB Act's focus on functional regulation relates to the application of federal securities laws and SEC oversight of some bank securities activities previously exempt from broker-dealer registration. Among other things, the GLB Act amended the definitions of "broker" and "dealer" under the Securities Exchange Act of 1934, as amended, to remove the blanket exemption for banks. Under the GLB Act, banks may conduct securities activities without broker-dealer registration only if the activities fall within a set of activity-based exemptions designed to allow banks to conduct only those activities traditionally considered to be primarily banking or trust activities.

Securities activities outside these exemptions, as a practical matter, need to be conducted by a registered broker-dealer affiliate. The GLB Act also amended the Investment Advisers Act of 1940 to require the registration of banks that act as investment advisers for mutual funds. The Company believes that it has taken the necessary actions to comply with these requirements of the GLB Act and the regulations adopted under them.

Anti-Terrorism Legislation

The USA PATRIOT Act of 2001 included the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (the "IMLAFA"). The IMLAFA contains anti-money laundering measures affecting insured depository institutions, broker-dealers, and certain other financial institutions. The IMLAFA requires U.S. financial institutions to adopt policies and procedures to combat money laundering and grants the Secretary of the Treasury broad authority to establish regulations and to impose requirements and restrictions on financial institutions' operations. The Company has established policies and procedures for compliance with the IMLAFA and the related regulations. The Company has designated an officer solely responsible for ensuring compliance with existing regulations and monitoring changes to the regulations as they occur.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") was signed into law on July 21, 2010. Generally, the Act is effective the day after it was signed into law, but different effective dates apply to specific sections of the law. The Act, among other things:

- Resulted in the Federal Reserve issuing rules limiting debit-card interchange fees.
- After a three-year phase-in period which began January 1, 2013, existing trust preferred securities for holding companies with consolidated assets greater than $15 billion and all new issuances of trust preferred securities are removed as a permitted component of a holding company's Tier 1 capital. Trust preferred securities outstanding as of May 19, 2010 that were issued by bank holding companies with total consolidated assets of less than $15 billion, such as First Mid Bank and Soy Capital Bank, will continue to count as Tier 1 capital.
- Provides for new disclosure and other requirements relating to executive compensation and corporate governance.
- Changes standards for Federal preemption of state laws related to federally chartered institutions and their subsidiaries.

- Provides mortgage reform provisions including (i) a customer’s ability to repay, (ii) restricting variable-rate lending by requiring the ability to repay to be determined for variable-rate loans by requiring lenders to evaluate using the maximum rate that will apply during the first five years of a variable-rate loan term, and (iii) making more loans subject to provisions for higher cost loans and new disclosures.

- Creates a financial stability oversight council that will recommend to the Federal Reserve increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity.

- Permanently increases the deposit insurance coverage to $250 thousand and allows depository institutions to pay interest on checking accounts.

- Requires publicly-traded bank holding companies with assets of $10 billion or more to establish a risk committee responsible for enterprise-wide risk management practices.

- Limits and regulates, under the provisions of the Act know as the Volker Rule, a financial institution's ability to engage in proprietary trading or to own or invest in certain private equity and hedge funds.

Basel III

In September 2010, the Basel Committee on Banking Supervision proposed higher global minimum capital standards, including a minimum Tier 1 common capital ratio and additional capital and liquidity requirements. On July 2, 2013, the Federal Reserve Board approved a final rule to implement these reforms and changes required by the Dodd-Frank Act. This final rule was subsequently adopted by the OCC and the FDIC.

The final rule included new risk-based capital and leverage ratios, which are being phased in from 2015 to 2019, and refined the definition of what constitutes “capital” for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Company and First Mid Bank beginning in 2015 were: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6%; (iii) a total capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4%. The rule also established a “capital conservation buffer” of 2.5% above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital and will result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625% of risk weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if its capital level falls below the buffer amount.

The final rule also made three changes to the proposed rule of June 2012 that impacted the Company. First, the proposed rule required banking organizations to include accumulated other comprehensive income (“AOCI”) in common equity tier 1 capital. AOCI includes accumulated unrealized gains and losses on certain assets and liabilities that have not been included in net income. Under existing general risk-based capital rules, most components of AOCI are not included in a banking organization's regulatory capital calculations. The final rule allowed community banking organizations to make a one-time election not to include these additional components of AOCI in regulatory capital and instead use the existing treatment under the general risk-based capital rules that excludes most AOCI components from regulatory capital. The Company has made this election.

Second, the proposed rule modified the risk-weight framework applicable to residential mortgage exposures to require banking organizations to divide residential mortgage exposure into two categories in order to determine the applicable risk weight. The final rule, however, retained the existing treatment for residential mortgage exposures under the general risk-based capital rules.

Third, the proposed rule required banking organizations with total consolidated assets of less than $15 billion as of December 31, 2009, such as the Company, to phase out over ten years any trust preferred securities and cumulative perpetual preferred securities from its Tier 1 capital regulatory capital. The final rule, however, permanently grandfathers into Tier 1 capital of depository institution holding companies with total consolidated assets of less than $15 billion as of December 31, 2009 any trust preferred securities or cumulative perpetual preferred stock issued before May 19, 2010.

The Company

General. As a registered financial holding company under the BHCA that has elected to become a financial holding company under the GLB Act, the Company is subject to regulation by the Federal Reserve Board. In accordance with Federal Reserve Board policy, the Company is expected to act as a source of financial strength to First Mid Bank and to commit resources to support First Mid Bank in circumstances where the Company might not do so absent such policy. The Company is subject to inspection, examination, and supervision by the Federal Reserve Board.

Activities. As a financial holding company, the Company may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature. A bank holding company that is not also a financial holding company is limited to engaging in banking and such other activities as determined by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

No Federal Reserve Board approval is required for the Company to acquire a company (other than a bank holding company, bank, or savings association) engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board. However, the Company generally must give the Federal Reserve Board after-the-fact notice of these activities. Prior Federal Reserve Board approval is required before the Company may acquire beneficial ownership or control of more than 5% of the voting shares or substantially all of the assets of a bank holding company, bank, or savings association.

If any subsidiary bank of the Company ceases to be “well-capitalized” or “well-managed” under applicable regulatory standards, the Federal Reserve Board may, among other actions, order the Company to divest its depository institution. Alternatively, the Company may elect to conform its activities to those permissible for a bank holding company that is not also a financial holding company.

If any subsidiary bank of the Company receives a rating under the Community Reinvestment Act of less than “satisfactory”, the Company will be prohibited, until the rating is raised to “satisfactory” or better, from engaging in new activities or acquiring companies other than bank holding companies, banks, or savings associations.

Capital Requirements. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve Board capital adequacy guidelines. The Federal Reserve Board’s capital guidelines establish the following minimum regulatory capital requirements for bank holding companies for 2018, which include the partial phase in of the capital conservation buffer: a total capital to total risk-based capital ratio of not less than 9.875%, a Tier 1 risk-based ratio of not less than 7.875%, a common equity Tier 1 capital ratio of not less than 6.375%, and a Tier 1 leverage ratio of not less than 4.00%. For purposes of these capital standards, Tier 1 capital consists primarily of permanent stockholders’ equity, less intangible assets (other than certain mortgage servicing rights and purchased credit card relationships), and total capital means Tier 1 capital plus certain other debt and equity instruments which do not qualify as Tier 1 capital, limited amounts of unrealized gains on equity securities and a portion of the Company’s allowance for loan and lease losses.

The risk-based and leverage standards described above are minimum requirements, and higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve Board’s capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (i.e., Tier 1 capital less all intangible assets), well above the minimum levels.

As of December 31, 2018, the Company had regulatory capital, calculated on a consolidated basis, in excess of the Federal Reserve Board’s minimum requirements, and its capital ratios exceeded those required for categorization as well-capitalized under the capital adequacy guidelines established by bank regulatory agencies with a total risk-based capital ratio of 13.63%, a Tier 1 risk-based ratio of 12.76%, a common equity Tier 1 capital ratio of 11.81% and a leverage ratio of 11.15%.

Control Acquisitions. The Change in Bank Control Act prohibits a person or group of person from acquiring “control” of a bank holding company unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, such as the Company, would, under the circumstances set forth in the presumption, constitute acquisition of control of the Company. In addition, any company is required to obtain the approval of the Federal Reserve Board under the BHCA before acquiring 25% (5% in the case of an acquirer that is a bank holding company) or more of the outstanding common of the Company, or otherwise obtaining control of a “controlling influence” over the Company or First Mid Bank.

Interstate Banking and Branching. The Dodd-Frank Act expands the authority of banks to engage in interstate branching. The Dodd-Frank Act allows a state or national bank to open a de novo branch in another state if the law of the state where the branch is to be located would permit a state bank chartered by that state to open the branch.

Privacy and Security. The GLB Act establishes a minimum federal standard of financial privacy by, among other provisions, requiring banks to adopt and disclose privacy policies with respect to consumer information and setting forth certain rules with respect to the disclosure to third parties of consumer information. The Company has adopted and disseminated its privacy policies pursuant to the GLB Act. Regulations adopted under the GLB Act set standards for protecting the security, confidentiality and integrity of customer information, and require notice to regulators, and in some cases, to customers, in the event of security breaches. A number of states have adopted their own statutes requiring notification of security breaches. In addition, the GLB Act requires the disclosure of agreements reached with community groups that relate to the CRA, and contains various other provisions designed to improve the delivery of financial services to consumers while maintaining an appropriate level of safety in the financial services industry.

First Mid Bank and Soy Capital Bank

General. First Mid Bank is a national bank, chartered under the National Bank Act. Soy Capital Bank is an Illinois state-chartered bank. The FDIC insures the deposit accounts of the Banks. The Banks are members of the Federal Reserve System and are subject to the examination, supervision, reporting and enforcement requirements of the OCC, as the primary federal regulator of national banks, the Illinois Department of Financial and Professional Regulation, Division of Banking (the "IDFPR"), as the primary regulator of Illinois chartered banks, and the FDIC, as administrator of the deposit insurance fund.

Deposit Insurance. As an FDIC-insured institution, the Banks are required to pay deposit insurance premium assessments to the FDIC. On July 21, 2010, The Dodd-Frank Act permanently raised the standard maximum deposit insurance amount from $100,000 to $250,000.

On February 27, 2009, the FDIC adopted a final rule setting initial base assessment rates beginning April 1, 2009, at 12 to 45 basis points and, due to extraordinary circumstances, extended the period of the restoration plan to increase the deposit insurance fund to seven years. Also on February 27, 2009, the FDIC issued final rules on changes to the risk-based assessment system which imposes rates based on an institution’s risk to the deposit insurance fund. The rates increased the range of annual risk based assessment rates from 5 to 7 basis points to 7 to 24 basis points. The final rules both increase base assessment rates and incorporate additional assessments for excess reliance on brokered deposits and FHLB advances. This new assessment took effect April 1, 2009. The Company expensed $967,000, $779,000 and $851,000 for this assessment during 2018, 2017 and 2016, respectively. The increase in this assessment was primarily due to an increase in quarterly average assets.

In addition to its insurance assessment, each insured bank was subject to quarterly debt service assessments in connection with bonds issued by a government corporation that financed the federal savings and loan bailout. The Company expensed $92,000, $126,000 and $115,000 during 2018, 2017 and 2016, respectively, for this assessment.

OCC Assessments. All national banks are required to pay supervisory fees to the OCC to fund the operations of the OCC. The amount of such supervisory fees is based upon each institution's total assets, including consolidated subsidiaries, as reported to the OCC. During the year ended December 31, 2018, 2017, and 2016 the Company expensed supervisory fees totaling $596,000, $582,000, and $453,000, respectively. Changes in total expense are due to changes in assessment rates and increases in total assets of the bank.

Capital Requirements. The banking regulators has established the following minimum capital standards for banks for 2018, which include the partial phase in of the capital conservation buffer in a total capital to total risk-based capital ratio of not less than 9.875%, a Tier 1 risk-based ratio of not less than 7.875%, a common equity Tier 1 capital ratio of not less than 6.375%, and a Tier 1 leverage ratio of not less than 4.00%. For purposes of these capital standards, Tier 1 capital and total capital consists of substantially the same components as Tier 1 capital and total capital under the Federal Reserve Board's capital guidelines for bank holding companies (See "The Company—Capital Requirements").

The capital requirements described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, the banking regulators provide that additional capital may be required to take adequate account of, among other things, interest rate risk or the risks posed by concentrations of credit, nontraditional activities or securities trading activities.

During the year ended December 31, 2018, First Mid Bank and Soy Capital Bank were not required to increase capital to an amount in excess of the minimum regulatory requirements, and capital ratios exceeded those required for categorization as well-capitalized under the capital adequacy guidelines established by bank regulatory agencies. First Mid Bank's total risk-based capital ratio was 12.85%, Tier 1 risk-based ratio was 11.89%, common equity Tier 1 ratio was 11.89% and leverage ratio was 9.92%. Soy Capital Bank's total risk-based capital ratio was 14.33%, Tier 1 risk-based ratio was 14.33% and leverage ratio was 11.12%.

Prompt Corrective Action. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "well-capitalized," "adequately-capitalized," "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: requiring the submission of a capital restoration plan; placing limits on asset growth and restrictions on activities; requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; restricting transactions with affiliates; restricting the interest rate the institution may pay on deposits; ordering a new election of directors of the institution; requiring that senior executive officers or directors be dismissed; prohibiting the institution from accepting deposits from correspondent banks; requiring the institution to divest certain subsidiaries; prohibiting the payment of principal or interest on subordinated debt; and in the most severe cases, appointing a conservator or receiver for the institution.

Dividends. The National Bank Act and the Illinois Banking Act impose limitations on the amount of dividends that may be paid by a bank. Generally, a bank may pay dividends out of its undivided profits, in such amounts and at such times as the bank's board of directors deems prudent. Without prior OCC approval, however, a national bank may not pay dividends in any calendar year which, in the aggregate, exceed the bank's year-to-date net income plus the bank's adjusted retained net income for the two preceding years.

The payment of dividends by any financial institution or its holding company is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, First Mid Bank and Soy Capital Bank exceeded minimum capital requirements under applicable guidelines as of December 31, 2018. As of December 31, 2018, approximately $28.8 million was available to be paid as dividends to the Company by First Mid Bank. Notwithstanding the availability of funds for dividends, however, the OCC or IDFPR may prohibit the payment of any dividends if the OCC or IDFPR, as applicable, determines that such payment would constitute an unsafe or unsound practice.

Affiliate and Insider Transactions. First Mid Bank and Soy Capital Bank are subject to certain restrictions under federal law, including Regulation W of the Federal Reserve Board, on extensions of credit to the Company and its subsidiaries, on investments in the stock or other securities of the Company and its subsidiaries and the acceptance of the stock or other securities of the Company or its subsidiaries as collateral for loans. Certain limitations and reporting requirements are also placed on extensions of credit by First Mid Bank and Soy Capital Bank to their directors and officers, to directors and officers of the Company and its subsidiaries, to principal stockholders of the Company, and to "related interests" of such directors, officers and principal stockholders.

First Mid Bank and Soy Capital Bank is subject to restrictions under federal law that limits certain transactions with the Company, including loans, other extensions of credit, investments or asset purchases. Such transactions by a banking subsidiary with any one affiliate are limited in amount to 10% of the bank's capital and surplus and, with all affiliates together, to an aggregate of 20% of the bank's capital and surplus. Furthermore, such loans and extensions of credit, as well as certain other transactions, are required to be secured in specified amounts. These and certain other transactions, including any payment of money to the Company, must be on terms and conditions that are or in good faith would be offered to nonaffiliated companies.

In addition, federal law and regulations may affect the terms upon which any person becoming a director or officer of the Company or one of its subsidiaries or a principal stockholder of the Company may obtain credit from banks with which First Mid Bank or Soy Capital Bank maintains a correspondent relationship.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings. In general, the guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution's primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. The preamble to the guidelines states that the agencies expect to require a compliance plan from an institution whose failure to meet one or more of the guidelines are of such severity that it could threaten the safety and soundness of the institution. Failure to submit an acceptable plan, or failure to comply with a plan that has been accepted by the appropriate federal regulator, would constitute grounds for further enforcement action.

Community Reinvestment Act. First Mid Bank and Soy Capital Bank is subject to the Community Reinvestment Act (CRA). The CRA and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their service areas, including low and moderate income neighborhoods, consistent with the safe and sound operations of the banks. These regulations also provide for regulatory assessment of a bank's record in meeting the needs of its service area when considering applications to establish branches, merger applications and applications to acquire the assets and assume the liabilities of another bank. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 requires federal banking agencies to make public a rating of a bank's performance under the CRA. In the case of a bank holding company, the CRA performance record of its bank subsidiaries is reviewed by federal banking agencies in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or thrift or to merge with any other bank holding company. An unsatisfactory record can substantially delay or block the transaction. First Mid Bank and Soy Capital Bank received satisfactory CRA ratings from their regulator in their most recent CRA examination.

Consumer Laws and Regulations. In addition to the laws and regulations discussed above, First Mid Bank and Soy Capital Bank are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, the Fair and Accurate Credit Transactions Act and the Real Estate Settlement Procedures Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans to or marketing to or engaging in other types of transactions with such customers. Failure to comply with these laws and regulations could lead to substantial penalties, operating restrictions and reputational damage to the financial institution.

Supplemental Item – Executive Officers of the Registrant

The executive officers of the Company are elected annually by the Company's Board of Directors and are identified below.

Name (Age)	Position With Company
Joseph R. Dively (59)	Chairman of the Board of Directors, President and Chief Executive Officer
Michael L. Taylor (50)	Senior Executive Vice President and Chief Operating Officer
Matthew K. Smith (44)	Executive Vice President and Chief Financial Officer
Eric S. McRae (53)	Executive Vice President
Bradley L. Beesley (47)	Executive Vice President
Laurel G. Allenbaugh (58)	Executive Vice President
Clay M. Dean (44)	Executive Vice President
Amanda D. Lewis (39)	Executive Vice President
David Hiden (57)	Senior Vice President
Christopher L. Slabach (56)	Senior Vice President
Rhonda Gatons (47)	Senior Vice President

Joseph R. Dively, age 59, is the Chairman of the Board of Directors, President and Chief Executive Officer of the Company since January 1, 2014 and the President of First Mid Bank since May 2011. Prior to assuming these positions in the Company, he was the Senior Executive Vice President of the Company beginning in May 2011. He was with Consolidated Communications Holdings, Inc. in Mattoon, Illinois from 2003 to May 2011.

Michael L. Taylor, age 50, has been Senior Executive Vice President since 2014 and Chief Operating Officer since July 2017. He served as Chief Financial Officer of the Company from 2000 to 2017. He served as Executive Vice President from 2007 to 2014 and as Vice President from 2000 to 2007. He was with AMCORE Bank in Rockford, Illinois from 1996 to 2000.

Matthew K. Smith, age 44, has been Executive Vice President of the Company since November 2016 and Chief Financial Officer since July 2017. He served as Director of Finance from November 2016 to July 2017. He was Treasurer and Vice President of Finance and Investor Relations with Consolidated Communications, Inc from 1997 to 2016.

Eric S. McRae, age 53, has been Executive Vice President of the Company and Executive Vice President, Chief Credit Officer of First Mid Bank since January 2017. He served as Senior Lender of First Mid Bank from December 2008 to December 2016 and he served as President of the Decatur region from 2001 to December 2008.

Bradley L. Beesley, age 47, has been Executive Vice President of the Company and Chief Trust & Wealth Management Officer of First Mid Bank since March 2015 and First Mid Wealth Management Company since July 2018. He served as Senior Vice President from May 2007 to March 2015.

Laurel G. Allenbaugh, age 58, has been Executive Vice President of the Company and Executive Vice President, Chief Operations Officer of First Mid Bank since April 2008. She served as Vice President of Operations from February 2000 to April 2008. She served as Controller of the Company and First Mid Bank from 1990 to February 2000 and has been President of MIDS since 1998.

Clay M. Dean, age 44, has been Executive Vice President of the Company since January 2019 and Senior Vice President of the Company since 2010 and Senior Vice President and Chief Insurance Services Officer of the First Mid Bank and Chief Executive Officer of First Mid Insurance since September 2014. He served as Senior Vice President, Chief Deposit Services Officer of First Mid Bank from November 2012 to September 2014 and as Senior Vice

President, Director of Treasury Management of First Mid Bank from 2010 to 2012.

Amanda D. Lewis, age 39, has been Executive Vice President of the Company since January 2019 and Senior Vice President of the Company and Senior Vice President, Retail Banking Officer of First Mid Bank since September 2014. She served as Vice President, Director of Marketing from 2001 until September 2014.

David Hiden, age 57, has been Senior Vice President, Chief Information Officer of the Company since July 2018.

Christopher L. Slabach, age 56, has been Senior Vice President of the Company since 2007 and Senior Vice President, Chief Risk Officer of First Mid Bank since 2008. He served as Vice President, Audit of the Company from 1998 to 2007.

Rhonda Gatons, age 47, has been Senior Vice President of the Company and Director of Human Resources since March 2016. Prior to joining the Company, she was the Director of Human Resources at Midland States Bank.

ITEM 1A. RISK FACTORS

Various risks and uncertainties, some of which are difficult to predict and beyond the Company's control, could negatively impact the Company. As a financial institution, the Company is exposed to interest rate risk, liquidity risk, credit risk, operational risk, risks from economic or market conditions, and general business risks among others. Adverse experience with these or other risks could have a material impact on the Company's financial condition and results of operations, as well as the value of its common stock.

Difficult economic conditions and market disruption have adversely impacted the banking industry and financial markets generally and may again significantly affect the business, financial condition, or results of operations of the Company. The Company's success depends, to a certain extent, upon economic and political conditions, local and national, as well as governmental monetary policies. Conditions such as inflation, recession, unemployment, changes in interest rates, money supply and other factors beyond the Company's control may adversely affect its asset quality, deposit levels and loan demand and, therefore, its earnings.

The Company's profitability depends significantly on economic conditions in the geographic region in which it operates. A large percentage of the Company's loans are to individuals and businesses in Illinois, consequently, any decline in the economy of this market area could have a materially adverse effect on the Company's financial condition and results of operations.

Decline in the strength and stability of other financial institutions may adversely affect the Company's business. The actions and commercial soundness of other financial institutions could affect the Company's ability to engage in routine funding transactions. Financial services institutions are interrelated as a result of clearing, counterparty or other relationships. The Company has exposure to different counterparties, and executes transactions with various counterparties in the financial industry. Recent defaults by financial services institutions, and even rumors or questions about one or more financial services institutions or the financial services industry in general, led to market-wide liquidity problems in recent years and could lead to losses or defaults by the Company or by other institutions. Many of these transactions expose the Company to credit risk in the event of default of its counterparty or client. Any such losses could materially and adversely affect the Company's results of operations.

Changes in interest rates may negatively affect our earnings. Changes in market interest rates and prices may adversely affect the Company's financial condition or results of operations. The Company's net interest income, its largest source of revenue, is highly dependent on achieving a positive spread between the interest earned on loans and investments and the interest paid on deposits and borrowings. Changes in interest rates could negatively impact the Company's ability to attract deposits, make loans, and achieve a positive spread resulting in compression of the net interest margin.

The Company may not have sufficient cash or access to cash to satisfy current and future financial obligations, including demands for loans and deposit withdrawals, funding operating costs and for other corporate purposes. This type of liquidity risk arises whenever the maturities of financial instruments included in assets and liabilities differ. The Company's liquidity can be affected by a variety of factors, including general economic conditions, market disruption, operational problems affecting third parties or the Company, unfavorable pricing, competition, the Company's credit rating and regulatory restrictions. (See "Liquidity" herein for management's actions to mitigate this risk.)

If the Company were unable to borrow funds through access to capital markets, it may not be able to meet the cash flow requirements of its depositors, creditors, and borrowers, or the operating cash needed to fund corporate expansion and other corporate activities. As seen starting in the middle of 2007, significant turmoil and volatility in worldwide financial markets can result in a disruption in the liquidity of financial markets, and could directly impact the Company to the extent it needs to access capital markets to raise funds to support its business and overall liquidity position. These types of situations could affect the cost of such funds or the Company's ability to raise such funds. If the Company were unable to access any of these funding sources when needed, it might be unable to meet customers' needs, which could adversely impact its financial condition, results of operations, cash flows, and level of regulatory-qualifying capital. For further discussion, see the "Liquidity" section.

Loan customers or other counter-parties may not be able to perform their contractual obligations resulting in a negative impact on the Company's earnings. Overall economic conditions affecting businesses and consumers, including the current difficult economic conditions and market disruptions, could impact the Company's credit losses. In addition, real estate valuations could also impact the Company's credit losses as the Company maintains $1.7 billion in loans secured by commercial, agricultural, and residential real estate. A significant decline in real estate values could have a negative effect on the Company's financial condition and results of operations. In addition, the Company's total loan balances by industry exceeded 25% of total risk-based capital for each of five industries as of December 31, 2018. A listing of these industries is contained in under "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations -- Loans" herein. A significant change in one of these industries such as a significant decline in agricultural crop prices, could adversely impact the Company's credit losses.

Deterioration in the real estate market could lead to losses, which could have a material adverse effect on the business, financial condition and results of operations or the Company. Commercial and commercial real estate loans generally involve higher credit risks than residential real estate and consumer loans. Because payments on loans secured by commercial real estate or equipment are often dependent upon the successful operation and management of the underlying assets, repayment of such loans may be influenced to a great extent by conditions in the market or the economy. Increases in commercial and consumer delinquency levels or declines in real estate market values would require increased net charge-offs and increases in the allowance for loan and lease losses, which could have a material adverse effect on our business, financial condition and results of operations and prospects.

The allowance for loan losses may prove inadequate or be negatively affected by credit risk exposures. The Company’s business depends on the creditworthiness of its customers. Management periodically reviews the allowance for loan and lease losses for adequacy considering economic conditions and trends, collateral values and credit quality indicators, including past charge-off experience and levels of past due loans and nonperforming assets. There is no certainty that the allowance for loan losses will be adequate over time to cover credit losses in the portfolio because of unanticipated adverse changes in the economy, market conditions or events adversely affecting specific customers, industries or markets. If the credit quality of the customer base materially decreases, if the risk profile of a market, industry or group of customers changes materially, or if the allowance for loan losses is not adequate, the Company’s business, financial condition, liquidity, capital, and results of operations could be materially adversely affected.

Declines in the value of securities held in the investment portfolio may negatively affect the Company’s earnings and capital. The value of an investment in the portfolio could decrease due to changes in market factors. The market value of certain investment securities is volatile and future declines or other-than-temporary impairments could materially adversely affect the Company’s future earnings and capital. Continued volatility in the market value of certain of the investment securities, whether caused by changes in market perceptions of credit risk, as reflected in the expected market yield of the security, or actual defaults in the portfolio could result in significant fluctuations in the value of the securities. This could have a material adverse impact on the Company’s accumulated other comprehensive loss and shareholders’ equity depending upon the direction of the fluctuations.

Furthermore, future downgrades or defaults in these securities could result in future classifications as other-than-temporarily impaired. The Company has invested in trust preferred securities issued by financial institutions and insurance companies, corporate securities of financial institutions, and stock in the Federal Home Loan Bank of Chicago and Federal Reserve Bank of Chicago. Deterioration of the financial stability of the underlying financial institutions for these investments could result in other-than-temporary impairment charges to the Company and could have a material impact on future earnings. For further discussion of the Company’s investments, see Note 4 – “Investment Securities.”

A failure in or breach of the company's operational or security systems, or those of it's third party service providers, including as a result of cyber-attacks, could disrupt the company's business, result in unintentional disclosure or misuse of confidential or proprietary information, damage the company's reputation, increase our costs and cause losses. As a financial institution, the company's operations rely heavily on the secure processing, storage and transmission of confidential and other information on it's computer systems and networks. Any failure, interruption or breach in security or operational integrity of these systems could result in failures or disruptions in the company's online banking system, customer relationship management, general ledger, deposit and loan servicing and other systems. The security and integrity of these systems could be threatened by a variety of interruptions or information security breaches, including those caused by computer hacking, cyber-attacks, electronic fraudulent activity or attempted theft of financial assets. Management cannot assert that any such failures, interruption or security breaches will not occur, or if they do occur that they will be adequately addressed. While certain protective policies and procedures are in place, the nature and sophistication of the threats continue to evolve. The Company may be required to expend significant additional resources in the future to modify and enhance these protective measures.

Additionally, the company faces the risk of operational disruption, failure, termination or capacity constraints of any of the third parties that facilitate its business activities, including exchanges, clearing agents, clearing houses or other financial intermediaries. Such parties could also be the source of an attack on, or breach of, its operational systems. Any failures, interruptions or security breaches in the company's information systems could damage its reputation, result in a loss of customer business, result in a violation of privacy or other laws, or expose us to civil litigation, regulatory fines or losses not covered by insurance.

If the Company’s stock price declines from levels at December 31, 2018, management will evaluate the goodwill balances for impairment, and if the values of the businesses have declined, the Company could recognize an impairment charge for its goodwill. Management performed an annual goodwill impairment assessment as of September 30, 2018. Based on these analyses, management concluded that the fair value of the Company’s reporting units exceeded the fair value of its assets and liabilities and, therefore, goodwill was not considered impaired. It is possible that management’s assumptions and conclusions regarding the valuation of the Company’s lines of business could change adversely, which could result in the recognition of impairment for goodwill, which could have a material effect on the Company’s financial position and future results of operations.

The Company may issue additional common stock or other equity securities in the future which could dilute the ownership interest of existing stockholders. In order to maintain capital at desired or regulatory-required levels, to replace existing capital, or to complete acquisitions the Company may be required to issue additional shares of common stock, or securities convertible into, exchangeable for or representing rights to acquire shares of common stock. The Company may sell these shares at prices below the current market price of shares, and the sale of these shares may significantly dilute stockholder ownership. The Company could also issue additional shares in connection with acquisitions of other financial institutions.

Human error, inadequate or failed internal processes and systems, and external events may have adverse effects on the Company. Operational risk includes compliance or legal risk, which is the risk of loss from violations of, or noncompliance with, laws, rules, regulations, prescribed practices, or ethical standards. Operational risk also encompasses transaction risk, which includes losses from fraud, error, the inability to deliver products or services, and loss or theft of information. Losses resulting from operational risk could take the form of explicit charges, increased operational costs, harm to the Company’s reputation or forgone opportunities. Any of these could potentially have a material adverse effect on the Company’s reputation, financial condition and results of operations.

The Company is exposed to various business risks that could have a negative effect on the financial performance of the Company. These risks include: changes in customer behavior, changes in competition, new litigation or changes to existing litigation, claims and assessments, environmental liabilities, real or threatened acts of war or terrorist activity, adverse weather, changes in accounting standards, legislative or regulatory changes, taxing authority interpretations, and an inability on the Company’s part to retain and attract skilled employees.

In addition to these risks identified by the Company, investments in the Company’s common stock involve risk. The market price of the Company’s common stock may fluctuate significantly in response to a number of factors including: volatility of stock market prices and volumes, rumors or erroneous information, changes in market valuations of similar companies, changes in securities analysts’ estimates of financial performance, and variations in quarterly or annual operating results.

If the Company is unable to make favorable acquisitions or successfully integrate our acquisitions, the Company’s growth could be impacted. In the past several years, the Company has completed acquisitions of banks, bank branches and other businesses. We may continue to make such acquisitions in the future. When the Company evaluates acquisition opportunities, the Company evaluates whether the target institution has a culture similar to the Company, experienced management and the potential to improve the financial performance of the Company. If the Company fails to successfully identify, complete and integrate favorable acquisitions, the Company could experience slower growth. Acquiring other banks, bank branches or businesses involves various risks commonly associated with acquisitions, including, among other things: potential exposure to unknown or contingent liabilities or asset quality issues of the target institution, difficulty and expense of integrating the operations and personnel of the target institution, potential disruption to the Company (including diversion of management’s time and attention), difficulty in estimating the value of the target institution, and potential changes in banking or tax laws or regulations that may affect the target institution.

The Company and the banking industry are subject to government regulation, legislation and policy. Government regulation, legislation and policy affect the Company and the banking industry as a whole, including the Company’s business and results of operations. The Company’s results of operations could be adversely affected by changes in how existing regulations are interpreted or applied by government agencies, or by the adoption of new government regulation, legislation and policy. These changes may require the Company to invest significant funds and management attention and resources in order to reach compliance.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company's headquarters is located at 1421 Charleston Avenue, Mattoon Illinois. This location is also used by the loan and deposit operations departments of First Mid Bank. In addition, the Company owns a facility located at 1500 Wabash Avenue, Mattoon, Illinois, which is used by branch support operations. In December 2018, the Company acquired a facility at 1420 Wabash Avenue which will also be used by branch support operations.

The main office of First Mid Bank is located at 1515 Charleston Avenue, Mattoon, Illinois and is owned by First Mid Bank. First Mid Bank also owns a building located at 1520 Charleston Avenue, which is used by First Mid Insurance, MIDS for its data processing and by First Mid Bank for back room operations. First Mid Bank also conducts business through numerous facilities, owned and leased, located in twenty-six counties throughout Illinois and one Missouri county. Of the fifty-five other banking offices operated by First Mid Bank, thirty-six are owned and twenty-one are leased from non-affiliated third parties. FIrst Mid Bank also has a loan production office in metro Indianapolis. In addition, the acquired ten additional facilities in the acquisition of Soy Capital of which eight are owned and two are leased from non-affiliated third parties.

None of the properties owned by the Corporation are subject to any major encumbrances. The Company believes these facilities are suitable and adequate to operate its banking and related business. The net investment of the Company and subsidiaries in real estate and equipment at December 31, 2018 was $59.1 million.

ITEM 3. LEGAL PROCEEDINGS

On February 13, 2018, an alleged class action complaint was filed by a purported stockholder of First Bank in the United States District Court for the District of Delaware captioned Parshall v. First BancTrust Corporation (Case No. 1:18- cv-00218) against the Company, Merger Sub, First Bank and members of First Bank's board of directors (the "Lawsuit"). The Lawsuit related to the Agreement and Plan of Merger, dated as of December 11, 2017 (as amended by the First Amendment to Agreement and Plan of Merger entered into as of January 18, 2018), among the Company, Merger Sub and First Bank and the merger contemplated thereby (the "Merger"). Among other things, the Lawsuit alleged that the Registration Statement on Form S-4 filed with the SEC by the Company on January 22, 2018 failed to disclose allegedly material information relating to the Company's and First Bank's financial projections, the analyses performed by First Bank's financial advisor, and alleged potential conflicts of interest of First Bank's officers, directors and financial advisor. The plaintiff sought, among other relief, to enjoin the Merger from proceeding. The Company believes that the factual allegations in the Lawsuit were without merit.

On March 9, 2018, in order to moot plaintiff's disclosure claims, reduce the expenses, burdens, risks and uncertainties inherent in litigation and avoid the risk of delaying or adversely affecting the Merger, in exchange for the plaintiff agreeing to withdraw the Lawsuit and dismiss his claims with prejudice, the Company and First Bank made additional supplemental disclosures to the proxy statement/prospectus related to the Merger that was first mailed to stockholders of First Bank on or about February 9, 2018. The agreement between the parties did not release or otherwise prejudice any potential claims of any member of the putative class other than the plaintiff and did not constitute any admission by any of the defendants as to the merits of any claims. In January 2019, the parties resolved the plaintiff's counsel's claim for an award of attorneys' fees and expenses pursuant to a confidential settlement agreement.

From time to time the Company and its subsidiaries may be involved in litigation that the Company believes is a type common to our industry. None of any such existing claims are believed to be individually material at this time to the Company, although the outcome of any such existing claims cannot be predicted with certainty.

ITEM 4. [RESERVED]

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER OF PURCHASES OF EQUITY SECURITIES

The Company’s common stock was held by approximately 1,031 shareholders of record as of December 31, 2018 and is included for quotation on the NASDAQ Stock Market, LLC under the trading symbol "FMBH".

The Company’s shareholders are entitled to receive dividends as are declared by the Board of Directors, which considers payment of dividends semi-annually. The ability of the Company to pay dividends, as well as fund its operations, is dependent upon receipt of dividends from First Mid Bank. Regulatory authorities limit the amount of dividends that can be paid by First Mid Bank without prior approval from such authorities. For further discussion of the Bank’s dividend restrictions, see Item1 – “Business” – “First Mid Bank” – “Dividends” and Note 16 – “Dividend Restrictio herein.

The following table summarizes share repurchase activity for the fourth quarter of 2018:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs at End of Period
October 1, 2018 – October 31, 2018	—	—	—	$6,280,000
November 1, 2018 – November 30, 2018	—	—	—	6,280,000
December 1, 2018 – December 31, 2018	1,312	32.58	1,312	6,238,000
Total	1,312	$32.58	1,312	$6,238,000

All of the repurchase activity that occurred during 2018 resulted from shares withheld to cover taxes on employee stock vesting. Since August 5, 1998, the Board of Directors has approved repurchase programs pursuant to which the Company may repurchase a total of approximately $76.7 million of the Company’s common stock. The repurchase programs approved by the Board of Directors are as follows:

- On August 5, 1998, repurchases of up to 3%, or $2 million, of the Company’s common stock.

- In March 2000, repurchases up to an additional 5%, or $4.2 million of the Company’s common stock.
- In September 2001, repurchases of $3 million of additional shares of the Company’s common stock.
- In August 2002, repurchases of $5 million of additional shares of the Company’s common stock.
- In September 2003, repurchases of $10 million of additional shares of the Company’s common stock.
- On April 27, 2004, repurchases of $5 million of additional shares of the Company’s common stock.
- On August 23, 2005, repurchases of $5 million of additional shares of the Company’s common stock.
- On August 22, 2006, repurchases of $5 million of additional shares of the Company’s common stock.
- On February 27, 2007, repurchases of $5 million of additional shares of the Company’s common stock.
- On November 13, 2007, repurchases of $5 million of additional shares of the Company’s common stock.
- On December 16, 2008, repurchases of $2.5 million of additional shares of the Company’s common stock.
- On May 26, 2009, repurchases of $5 million of additional shares of the Company’s common stock.
- On February 22, 2011, repurchases of $5 million of additional shares of the Company’s common stock.
- On November 13, 2012 repurchases of $5 million of additional shares of the Company’s common stock.
- On November 19, 2013, repurchases of $5 million additional shares of the Company's common stock.
- On October 28, 2014, repurchases of $5 million additional shares of the Company's common stock.

ITEM 6. SELECTED FINANCIAL DATA

The following sets forth a five-year comparison of selected financial data (dollars in thousands, except per share data).

	2018	2017	2016	2015	2014
Summary of Operations					
Interest income	$124,565	$99,555	$75,496	$59,251	$54,734
Interest expense	12,827	6,482	4,292	3,499	3,252
Net interest income	111,738	93,073	71,204	55,752	51,482
Provision for loan losses	8,667	7,462	2,826	1,318	629
Other income	35,414	30,336	26,912	20,544	18,369
Other expense	89,980	74,221	61,510	49,248	44,507
Income before income taxes	48,505	41,726	33,780	25,730	24,715
Income tax expense	11,905	15,042	11,940	9,218	9,254
Net income	36,600	26,684	21,840	16,512	15,461
Dividends on preferred shares	—	—	825	2,200	4,152
Net income available to common stockholders	$36,600	$26,684	$21,015	$14,312	$11,309
Per Common Share Data					
Basic earnings per share	$2.53	$2.13	$2.07	$1.84	$1.88
Diluted earnings per share	2.52	2.13	2.05	1.81	1.85
Dividends declared per share	0.70	0.66	0.62	0.59	0.55
Book value per common share	28.57	24.32	22.51	21.01	19.55
Tangible Book Value per common share	20.22	18.73	16.84	15,090.00	15.63
Capital Ratios					
Total capital to risk-weighted assets	13.63 %	12.70 %	12.79 %	14.25 %	15.60 %
Tier 1 capital to risk-weighted assets	12.76 %	11.83 %	11.99 %	13.23 %	14.42 %
Common equity tier 1 ratio	11.81 %	10.78 %	10.86 %	9.92 %	10.32 %
Tier 1 capital to average assets	11.15 %	9.91 %	9.19 %	9.20 %	10.52 %
Financial Ratios					
Net interest margin	3.71 %	3.57 %	3.28 %	3.27 %	3.43 %
Return on average assets	1.13 %	0.94 %	0.94 %	0.91 %	0.97 %
Return on average common equity	9.59 %	8.92 %	9.30 %	8.97 %	10.34 %
Dividend on common shares payout ratio	27.67 %	30.99 %	29.95 %	32.07 %	29.26 %
Average equity to average assets	11.77 %	10.59 %	10.12 %	10.34 %	9.94 %
Allowance for loan losses as a percent of total loans	0.99 %	1.03 %	0.92 %	1.14 %	1.29 %
Year End Balances					
Total assets	$3,839,734	$2,841,539	$2,884,535	$2,114,499	$1,607,103
Net loans, including loans held for sale	2,618,330	1,919,524	1,809,239	1,267,313	1,048,724
Total deposits	2,988,686	2,274,639	2,329,887	1,732,568	1,272,077
Total equity	475,864	307,964	280,673	205,009	164,916
Average Balances					
Total assets	$3,241,574	$2,825,702	$2,333,866	$1,807,998	$1,593,227
Net loans, including loans held for sale	2,253,469	1,818,317	1,439,192	1,112,413	1,008,980
Total deposits	2,569,033	2,273,949	1,893,203	1,455,047	1,293,621
Total equity	381,646	299,389	236,254	186,898	158,364

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is intended to provide a better understanding of the consolidated financial condition and results of operations of the Company and its subsidiaries years ended December 31, 2018, 2017 and 2016. This discussion and analysis should be read in conjunction with the consolidated financial statements, related notes and selected financial data appearing elsewhere in this report.

Forward-Looking Statements

This report may contain certain forward-looking statements, such as discussions of the Company's pricing and fee trends, credit quality and outlook, liquidity, new business results, expansion plans, anticipated expenses and planned schedules. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1955. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are identified by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project," or similar expressions. Actual results could differ materially from the results indicated by these statements because the realization of those results is subject to many risks and uncertainties, including those described in Item 1A. "Risk Factors" and other sections of the Company's Annual Report on Form 10-K and the Company's other filings with the SEC, and changes in interest rates, general economic conditions and those in the Company's market area, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios and the valuation of the investment portfolio, the Company's success in raising capital, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles, policies and guidelines. Furthermore, forward-looking statements speak only as of the date they are made. Except as required under the federal securities laws or the rules and regulations of the SEC, we do not undertake any obligation to update or review any forward-looking information, whether as a result of new information, future events or otherwise.

For the Years Ended December 31, 2018, 2017 and 2016

Overview

This overview of management's discussion and analysis highlights selected information in this document and may not contain all of the information that is important to you. For a more complete understanding of trends, events, commitments, uncertainties, liquidity, capital resources, and critical accounting estimates, you should carefully read this entire document. These have an impact on the Company's financial condition and results of operations.

Net income was $36.6 million, $26.7 million, and $21.8 million and diluted earnings per share were $2.52, $2.13, and $2.05 for the years ended December 31, 2018, 2017 and 2016, respectively. The following table shows the Company's annualized performance ratios for the years ended December 31, 2018, 2017 and 2016:

	2018	2017	2016
Return on average assets	1.13 %	0.94 %	0.94 %
Return on average common equity	9.59 %	8.92 %	9.30 %
Average common equity to average assets	11.77%	10.59%	10.12%

Total assets at December 31, 2018, 2017 and 2016 were $3.84 billion, $2.84 billion, and $2.88 billion, respectively. Net loan balances increased to $2.62 billion at December 31, 2018, from $1.92 billion at December 31, 2017, from $1.81 billion at December 31, 2016. The increase in 2018 was primarily due to loans acquired in the acquisition of First Bank and Soy Capital Bank. Of the increase in 2017, $58.5 million was due to increases in construction and land development loans and $51.6 million was due to increases in commercial real estate loans.

Total deposit balances increased to $2.99 billion at December 31, 2018 from $2.27 billion at December 31, 2017 and from $2.33 billion at December 31, 2016. The increase in 2018 was primarily due to deposits acquired in the acquisitions of First Bank and Soy Capital Bank. The decrease in 2017 was primarily due to a decrease in money market deposits and interest bearing deposits.

Net interest margin, defined as net interest income divided by average interest-earning assets, was 3.71% for 2018, 3.57% for 2017 and 3.28% for 2016. In 2018 the increase was primarily due to an increase in earnings assets, increases in average rates on earnings assets and accretion income from the acquisitions. In 2017, the increase was primarily due to an increase in earnings assets and net accretion income from the acquisition of First Clover Leaf.

Net interest income increased to $111.7 million in 2018 from $93.1 million in 2017 and $71.2 million in 2016. During 2018, net interest income increased primarily due to earning assets acquired from First Bank and Soy Capital Bank, increases in rates on earnings assets and net accretion income from all acquisitions. In 2017, the net interest income increased primarily due to growth in average earnings assets including loans and investments and net accretion income from the acquisition of First Clover Leaf. In 2016, net interest income increased primarily due to growth in average earnings assets including loans and investments primarily due to the acquisition of First Clover Leaf and the ONB branches.

Non-interest income increased to $35.4 million in 2018 compared to $30.3 million in 2017 and $26.9 million in 2016. Bank Owned Life insurance income decreased $249,000 or 15.2% due to a non-recurring death benefit of $511,000 received on a single policy in 2017. ATM revenue increased by $992,000 or 15.3%, and service charge income increased $515,000 or 7.4% primarily due to increased transactions. Insurance commissions increased $1,720,000 or

44.4% compared to last year due to additional revenues from commissions and contingency income. Additionally, other income decreased $761,000 primarily due to income tax refunds received in 2017 resulting from overpayment of taxes in 2016 by First Clover Leaf.

Non-interest expenses increased $15.8 million, to $90.0 million in 2018 compared to $74.2 million in 2017, and $61.5 million in 2016. The increase in 2018 was primarily due to expenses incurred to acquire and merge First Bank into First Mid Bank of approximately $5 million, expenses to acquire Soy Capital of approximately $900,000 and increases in salaries and benefits, occupancy and amortization expense related to these acquisitions. The increase during 2017 was primarily due to expenses of approximately $2 million associated with the merger of First Clover Leaf into First Mid Bank and an increase in operating expenses from the addition of First Clover Leaf Bank. Additionally, salaries and benefits expense increased $7.0 million or 17.7% compared to $39.8 million at the same period last year. The increase during 2016 was primarily due to expenses incurred of $1.3 million to acquire First Clover Leaf, expenses for the operation of the First Clover Leaf branches from acquisition in September to year-end and expense for the operation of the twelve ONB Branches acquired in August of 2015. In addition, 2016 salaries & benefits expense increased $7.4 million or 22.9%, and occupancy and equipment expense increased $1.2 million or 10.3%.

Following is a summary of the factors that contributed to the changes in net income (in thousands):

	2018 vs 2017	2017 vs 2016
Net interest income	$18,665	$21,869
Provision for loan losses	(1,205)	(4,636)
Other income, including securities transactions	5,078	3,424
Other expenses	(15,759)	(12,711)
Income taxes	3,137	(3,102)
Increase in net income	$9,916	$4,844

Credit quality is an area of importance to the Company. Year-end total nonperforming loans were $39.8 million at December 31, 2018 compared to $17.5 million at December 31, 2017, and $18.2 million at December 31, 2016. The increase in 2018 was primarily due to non performing loans acquired from First Bank. Repossessed Assets balances totaled $2.6 million at December 31, 2018 compared to $2.8 million at December 31, 2017, and $2 million at December 31, 2016. The increase in 2017 was primarily due to the addition of two 1-4 family residential borrowers and one commercial real estate borrower. The increase in 2016 was primarily due to properties acquired in the acquisition of First Clover Leaf Bank net of properties sold during 2016. The Company’s provision for loan losses was $8.7 million for 2018, compared to $7.5 million for 2017, and $2.8 million for 2016. The increase in provision expense in 2018 and 2017 was primarily due to increases in loan balances and net charge-offs. Loans secured by both commercial and residential real estate comprised 66%, 66%, and 67% of the loan portfolio for 2018, 2017, and 2016, respectively.

The Company’s capital position remains strong and the Company has consistently maintained regulatory capital ratios above the “well-capitalized” standards. The Company’s Tier 1 capital ratio to risk weighted assets ratio at December 31, 2018, 2017 and 2016 was 12.76%, 11.83%, and 11.99%, respectively. The Company’s total capital to risk weighted assets ratio at December 31, 2018, 2017 and 2016 was 13.63%, 12.70% ,and 12.79%, respectively. In 2017, the capital ratios declined in the fourth quarter due to reduced net income resulting from expense following remeasurement of deferred tax assets and liabilties, an increase in loan loss provision, strong loan growth, which drove a higher capital allocation on risk-weighted assets. In 2016, the primary reason for the decrease in these ratios was the First Clover Leaf acquisition which increased risk-weighted assets by approximately $649 million offset by stock issued of approximately $65.9 million, lower preferred dividends due to the conversion of Series C Preferred Stock, and the movement of cash from the Old National branch acquisition into loans and investments that require higher capital allocation.

The Company's liquidity position remains sufficient to fund operations and meet the requirements of borrowers, depositors, and creditors. The Company maintains various sources of liquidity to fund its cash needs. See "Liquidity" herein for a full listing of its sources and anticipated significant contractual obligations.

The Company enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include lines of credit, letters of credit and other commitments to extend credit. The total outstanding commitments at December 31, 2018, 2017 and 2016 were $564.1 million, $415.5 million, and $485.1 million, respectively. See Note 17 – "Commitments and Contingent Liabilities" herein for further information.

Critical Accounting Policies and Use of Significant Estimates

The Company has established various accounting policies that govern the application of U.S. generally accepted accounting principles in the preparation of the Company's financial statements. The significant accounting policies of the Company are described in the footnotes to the consolidated financial statements. Certain accounting policies involve significant judgments and assumptions by management that have a material impact on the carrying value of certain assets and liabilities; management considers such accounting policies to be critical accounting policies. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made by management, actual results could differ from these judgments and assumptions, which could have a material impact on the carrying values of assets and liabilities and the results of operations of the Company.

Allowance for Loan Losses. The Company believes the allowance for loan losses is the critical accounting policy that requires the most significant judgments and assumptions used in the preparation of its consolidated financial statements. An estimate of potential losses inherent in the loan portfolio are determined and an allowance for those losses is established by considering factors including historical loss rates, expected cash flows and estimated collateral values. In assessing these factors, the Company uses organizational history and experience with credit decisions and related outcomes. The allowance for loan losses represents the best estimate of losses inherent in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by loans charged off, net of recoveries. The Company evaluates the allowance for loan losses quarterly. If the underlying assumptions later prove to be inaccurate based on subsequent loss evaluations, the allowance for loan losses is adjusted.

The Company estimates the appropriate level of allowance for loan losses by separately evaluating impaired and nonimpaired loans. A specific allowance is assigned to an impaired loan when expected cash flows or collateral do not justify the carrying amount of the loan. The methodology used to assign an allowance to a nonimpaired loan is more subjective. Generally, the allowance assigned to nonimpaired loans is determined by applying historical loss rates to existing loans with similar risk characteristics, adjusted for qualitative factors including the volume and severity of identified classified loans, changes in economic conditions, changes in credit policies or underwriting standards, and changes in the level of credit risk associated with specific industries and markets. Because the economic and business climate in any given industry or market, and its impact on any given borrower, can change rapidly, the risk profile of the loan portfolio is continually assessed and adjusted when appropriate. Notwithstanding these procedures, there still exists the possibility that the assessment could prove to be significantly incorrect and that an immediate adjustment to the allowance for loan losses would be required.

Other Real Estate Owned. Other real estate owned acquired through loan foreclosure is initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. The adjustment at the time of foreclosure is recorded through the allowance for loan losses. Due to the subjective nature of establishing the fair value when the asset is acquired, the actual fair value of the other real estate owned or foreclosed asset could differ from the original estimate. If it is determined that fair value temporarily declines subsequent to foreclosure, a valuation allowance is recorded through noninterest expense. Operating costs associated with the assets after acquisition are also recorded as noninterest expense. Gains and losses on the disposition of other real estate owned and foreclosed assets are netted and posted to other noninterest expense.

Investment in Debt Securities. The Company classifies its investments in debt securities as either held-to-maturity or available-for-sale in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” which was codified into ASC 320. Securities classified as held-to-maturity are recorded at cost or amortized cost. Available-for-sale securities are carried at fair value. Fair value calculations are based on quoted market prices when such prices are available. If quoted market prices are not available, estimates of fair value are computed using a variety of techniques, including extrapolation from the quoted prices of similar instruments or recent trades for thinly traded securities, fundamental analysis, or through obtaining purchase quotes. Due to the subjective nature of the valuation process, it is possible that the actual fair values of these investments could differ from the estimated amounts, thereby affecting the financial position, results of operations and cash flows of the Company. If the estimated value of investments is less than the cost or amortized cost, the Company evaluates whether an event or change in circumstances has occurred that may have a significant adverse effect on the fair value of the investment. If such an event or change has occurred and the Company determines that the impairment is other-than-temporary, a further determination is made as to the portion of impairment that is related to credit loss. The impairment of the investment that is related to the credit loss is expensed in the period in which the event or change occurred. The remainder of the impairment is recorded in other comprehensive income.

Deferred Income Tax Assets/Liabilities. The Company’s net deferred income tax asset arises from differences in the dates that items of income and expense enter into our reported income and taxable income. Deferred tax assets and liabilities are established for these items as they arise. From an accounting standpoint, deferred tax assets are reviewed to determine if they are realizable based on the historical level of taxable income, estimates of future taxable income and the reversals of deferred tax liabilities. In most cases, the realization of the deferred tax asset is based on future profitability. If the Company were to experience net operating losses for tax purposes in a future period, the realization of deferred tax assets would be evaluated for a potential valuation reserve.

Additionally, the Company reviews its uncertain tax positions annually under FASB Interpretation No. 48 (FIN No. 48), “Accounting for Uncertainty in Income Taxes,” codified within ASC 740. An uncertain tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount actually recognized is the largest amount of tax benefit that is greater than 50% likely to be recognized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. A significant amount of judgment is applied to determine both whether the tax position meets the "more likely than not" test as well as to determine the largest amount of tax benefit that is greater than 50% likely to be recognized. Differences between the position taken by management and that of taxing authorities could result in a reduction of a tax benefit or increase to tax liability, which could adversely affect future income tax expense.

Impairment of Goodwill and Intangible Assets. Core deposit and customer relationships, which are intangible assets with a finite life, are recorded on the Company’s balance sheets. These intangible assets were capitalized as a result of past acquisitions and are being amortized over their estimated useful lives of up to 15 years. Core deposit intangible assets, with finite lives will be tested for impairment when changes in events or circumstances indicate that its carrying amount may not be recoverable. Core deposit intangible assets were tested for impairment during 2018 as part of the goodwill impairment test and no impairment was deemed necessary.

As a result of the Company’s acquisition activity, goodwill, an intangible asset with an indefinite life, is reflected on the balance sheets. Goodwill is evaluated for impairment annually, unless there are factors present that indicate a potential impairment, in which case, the goodwill impairment test is performed more frequently than annually.

Fair Value Measurements. The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The Company estimates the fair value of a financial instrument using a variety of valuation methods. Where financial instruments are actively traded and have quoted market prices, quoted market prices are used for fair value. When the financial instruments are not actively traded, other observable market inputs, such as quoted prices of securities with similar characteristics, may be used, if available, to determine fair value. When observable market prices do not exist, the Company estimates fair value. The Company’s valuation methods consider factors such as liquidity and concentration concerns. Other factors such as model assumptions, market dislocations, and unexpected correlations can affect estimates of fair value. Imprecision in estimating these factors can impact the amount of revenue or loss recorded.

SFAS No. 157, “Fair Value Measurements”, which was codified into ASC 820, establishes a framework for measuring the fair value of financial instruments that considers the attributes specific to particular assets or liabilities and establishes a three-level hierarchy for determining fair value based on the transparency of inputs to each valuation as of the fair value measurement date. The three levels are defined as follows:

- Level 1 — quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 — inputs include quoted prices for similar assets and liabilities in active markets, quoted prices of identical or similar assets or liabilities in markets that are not active, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 — inputs that are unobservable and significant to the fair value measurement.

At the end of each quarter, the Company assesses the valuation hierarchy for each asset or liability measured. From time to time, assets or liabilities may be transferred within hierarchy levels due to changes in availability of observable market inputs to measure fair value at the measurement date. Transfers into or out of hierarchy levels are based upon the fair value at the beginning of the reporting period. A more detailed description of the fair values measured at each level of the fair value hierarchy can be found in Note 11 – "Disclosures of Fair Values of Financial Instruments."

Results of Operations

Net Interest Income

The largest source of operating revenue for the Company is net interest income. Net interest income represents the difference between total interest income earned on earning assets and total interest expense paid on interest-bearing liabilities. The amount of interest income is dependent upon many factors, including the volume and mix of earning assets, the general level of interest rates and the dynamics of changes in interest rates. The cost of funds necessary to support earning assets varies with the volume and mix of interest-bearing liabilities and the rates paid to attract and retain such funds.

The Company's average balances, interest income and expense and rates earned or paid for major balance sheet categories are set forth in the following table (dollars in thousands):

	Year Ended December 31, 2018			Year Ended December 31, 2017			Year Ended December 31, 2016		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS									
Interest-bearing deposits	$27,911	$482	1.73 %	$28,544	$291	1.02 %	$38,359	$195	0.51 %
Federal funds sold	615	8	1.32 %	9,025	62	0.69 %	8,392	40	0.48 %
Certificates of deposit investments	3,013	66	2.18 %	3,317	50	1.50 %	28,777	295	1.02 %
Investment securities									
Taxable	514,220	13,070	2.54 %	559,657	11,708	2.09 %	514,096	9,260	1.80 %
Tax-exempt (1)	173,151	5,167	2.98 %	171,678	4,774	2.78 %	122,987	3,754	3.05 %
Loans (2) (3)	2,276,500	105,772	4.65 %	1,836,617	82,670	4.50 %	1,454,591	61,952	4.26 %
Total earning assets	2,995,410	124,565	4.16 %	2,608,838	99,555	3.82 %	2,167,202	75,496	3.47 %
Cash and due from banks	48,948			55,937			49,632		
Premises and equipment	45,780			39,176			33,389		
Other assets	174,467			140,051			99,042		
Allowance for loan losses	(23,031)			(18,300)			(15,399)		
Total assets	$3,241,574			$2,825,702			$2,333,866		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Deposits:									
Demand deposits, interest-bearing	$1,194,089	3,293	0.28 %	$1,119,835	1,811	0.16 %	$881,994	993	0.11 %
Savings deposits	395,028	579	0.15 %	367,261	486	0.13 %	340,746	445	0.13 %
Time deposits	473,043	4,699	0.99 %	348,278	1,697	0.49 %	298,124	1,275	0.43 %
Securities sold under agreements									
to repurchase	140,622	330	0.23 %	144,674	181	0.13 %	129,734	96	0.07 %
FHLB advances	97,701	2,071	2.12 %	57,405	883	1.54 %	36,648	630	1.72 %
Federal funds purchased	3,794	97	2.55 %	3,996	61	1.51 %	1,795	14	0.77 %
Subordinated debentures	27,391	1,409	5.14 %	23,956	927	3.87 %	21,650	672	3.10 %
Other debt	10,103	349	3.45 %	13,289	436	3.28 %	6,202	167	2.69 %
Total interest-bearing liabilities	2,341,771	12,827	0.55 %	2,078,694	6,482	0.31 %	1,716,893	4,292	0.25 %
Demand deposits	506,873			438,575			372,339		
Other liabilities	11,284			9,144			8,380		
Stockholders' equity	381,646			299,289			236,254		
Total liabilities & equity	$3,241,574			$2,825,702			$2,333,866		
Net interest income		$111,738			$93,073			$71,204	
Net interest spread			3.61 %			3.51 %			3.22 %
Impact of non-interest bearing funds			0.10 %			0.06 %			0.06 %
Net yield on interest-earning assets			3.71 %			3.57 %			3.28 %

(1) The tax-exempt income is not recorded on a tax equivalent basis.
(2) Nonaccrual loans have been included in the average balances.
(3) Includes loans held for sale.

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Changes in net interest income may also be analyzed by segregating the volume and rate components of interest income and interest expense. The following table summarizes the approximate relative contribution of changes in average volume and interest rates to changes in net interest income for the past two years (in thousands):

	2018 Compared to 2017 Increase – (Decrease)			2017 Compared to 2016 Increase – (Decrease)		
	Total Change	Volume (1)	Rate (1)	Total Change	Volume (1)	Rate (1)
Earning Assets:						
Interest-bearing deposits	$191	$(6)	$197	$96	$(60)	$156
Federal funds sold	(54)	(85)	31	22	3	19
Certificates of deposit investments	16	(5)	21	(245)	(340)	95
Investment securities:						
Taxable	1,362	(1,006)	2,368	2,448	869	1,579
Tax-exempt (2)	393	41	352	1,020	1,378	(358)
Loans (3)	23,102	20,280	2,822	20,718	17,059	3,659
Total interest income	25,010	19,219	5,791	24,059	18,909	5,150
Interest-Bearing Liabilities:						
Deposits:						
Demand deposits, interest-bearing	1,482	121	1,361	818	305	513
Savings deposits	93	31	62	41	41	—
Time deposits	3,002	780	2,222	422	231	191
Securities sold under agreements to repurchase	149	(5)	154	85	10	75
FHLB advances	1,188	773	415	253	325	(72)
Federal funds purchased	36	(3)	39	47	27	20
Subordinated debentures	482	147	335	255	76	179
Other debt	(87)	(109)	22	269	225	44
Total interest expense	6,345	1,735	4,610	2,190	1,240	950
Net interest income	$18,665	$17,484	$1,181	$21,869	$17,669	$4,200

(1) Changes attributable to the combined impact of volume and rate have been allocated proportionately to the change due to volume and the change due to rate.
(2) The tax-exempt income is not recorded on a tax equivalent basis.
(3) Nonaccrual loans are not material and have been included in the average balances.

Net interest income increased $18.7 million or 20.1% in 2018 compared to an increase of $21.9 million or 30.7% in 2017. Net interest income increased primarily due to the growth in average earnings assets including loans and investments acquired from First Bank and Soy Capital Bank. The net interest margin was higher due to growth in earnings assets, increases in rates on earning assets and net accretion income related to the acquisition of First Bank and Soy Capital Bank.

In 2018, average earning assets increased by $386.6 million, or 14.8%, and average interest-bearing liabilities increased by $263.1 million or 12.7%. In 2017, average earning assets increased by $441.6 million or 20.4% and average interest-bearing liabilities increased $361.8 million or 21.1% compared with 2016. Changes in average balances are shown below:

- Average interest-bearing deposits held by the Company decreased $0.6 million or 2.2% in 2018 compared to 2017. In 2017, average interest-bearing deposits held by the Company decreased $9.8 million or 25.6% compared to 2016.

- Average federal funds sold decreased $8.4 million or 93.2% in 2018 compared to 2017. In 2017, average federal funds sold increased $633,000 or 7.5% compared to 2016.

- Average certificates of deposit investments decreased $0.3 million or 9.2% in 2018 compared to 2017. In 2017, average certificates of deposit investments decreased $25.5 million or 88.5% compared to 2016.

- Average loans increased by $439.9 million or 24.0% in 2018 compared to 2017. In 2017, average loans increased by $382.0 million or 26.3% compared to 2016.

- Average securities decreased by $44.0 million or 6.0% in 2018 compared to 2017. In 2017, average securities increased by $94.3 million or 14.8% compared to 2016.

- Average deposits increased by $226.8 million or 12.4% in 2018 compared to 2017. In 2017, average deposits increased by $314.5 million or 20.7% compared to 2016.

- Average securities sold under agreements to repurchase decreased by $4.1 million or 2.8% in 2018 compared to 2017. In 2017, average securities sold under agreements to repurchase increased by $14.9 million or 11.5% compared to 2016.

- Average borrowings and other debt increased by $40.3 million or 40.9% in 2018 compared to 2017. In 2017, average borrowings and other debt increased by $32.4 million or 48.8% compared to 2016.

- Net interest margin increased to 3.71% compared to 3.57% in 2017 and 3.28% in 2016. Asset yields increased by 34 basis points in 2018, and interest-bearing liabilities increased by 24 basis points.

To compare the tax-exempt yields on interest-earning assets to taxable yields, the Company also computes non-GAAP net interest income on a tax equivalent basis where the interest earned on tax-exempt securities is adjusted to an amount comparable to interest subject to normal income taxes, assuming a federal tax rate of 21% for 2018 and 35% for 2017 and 2016 (referred to as the tax equivalent adjustment). The tax equivalent basis adjustments to net interest income for 2018, 2017 and 2016 were $2,025,000, $3,404,000, and $2,428,000, respectively. The net yield on interest-earning assets on a tax equivalent basis was 3.79% in 2018, 3.70% in 2017 and 3.39% in 2016.

Provision for Loan Losses

The provision for loan losses in 2018 was $8,667,000 compared to $7,462,000 in 2017 and $2,826,000 in 2016. Nonperforming loans increased to $39,839,000 at December 31, 2018 from $17,513,000 at December 31, 2017 and $18,241,000 at December 31, 2016. The increase in provision expense in 2018 and 2017 was primarily due to a increase in loan volume. Net charge-offs were $2,455,000 during 2018, $4,238,000 during 2017 and $649,000 during 2016. For information on loan loss experience and nonperforming loans, see “Nonperforming Loans and Repossessed Assets” and “Loan Quality and Allowance for Loan Losses” herein.

Other Income

An important source of the Company’s revenue is derived from other income. The following table sets forth the major components of other income for the last three years (in thousands):

				$ Change From Prior Year	
	2018	2017	2016	2018	2017
Trust	$5,786	$3,744	$3,517	$2,042	$227
Brokerage	2,674	2,161	1,908	513	253
Insurance commissions	5,592	3,872	3,452	1,720	420
Service charges	7,435	6,920	6,791	515	129
Securities gains	901	616	1,192	285	(576)
Mortgage banking	1,205	1,184	1,172	21	12
ATM / debit card revenue	7,487	6,495	6,004	992	491

Bank Owned Life Insurance	1,389	1,638	671	(249)	967
Other	2,945	3,706	2,205	(761)	1,501
Total other income	$35,414	$30,336	$26,912	$5,078	$3,424

Total non-interest income increased to $35.4 million in 2018 compared to $30.3 million in 2017 and $26.9 million in 2016. The primary reasons for the more significant year-to-year changes in other income components are as follows:

- Trust revenues increased $2,042,000 or 54.5% in 2018 to $5,786,000 from $3,744,000 in 2017 compared to $3,517,000 in 2016. The increases 2018 were due to an increases in market value and revenue from defined contribution and other retirement accounts and accounts added with the acquisition of Soy Capital. Trust assets under management were $1,129.6 million at December 31, 2018 compared to $997.8 million at December 31, 2017 and $831.6 million at December 31, 2016.

- Revenue from brokerage increased $513,000 or 23.7% to $2,674,000 in 2018 from $2,161,000 in 2017 and $1,908,000 in 2016 primarily due to an increase in the number of brokerage accounts from new business development efforts.

- Insurance commissions increased $1,720,000 or 44.4% to $5,592,000 in 2018 from $3,872,000 in 2017 and $3,452,000 in 2016. The growth is primarily due to growth in senior care policies underwritten through the Illiana Insurance Agency branch from insurance activities and revenues following the acquisition of Soy Capital.

- Fees from service charges increased $515,000 or 7.4% to $7,435,000 in 2018 from $6,920,000 in 2017 and $6,791,000 in 2016. The increase in 2018 was primarily due to a increase in income from the First Bank acquisition. The increase in 2017 was due to First Clover Leaf acquisition in place for a full year.

- Net securities gains in 2018 were $901,000 compared to $616,000 in 2017 and $1,192,000 in 2016.

- Mortgage banking income increased $21,000 or 1.8% to $1,205,000 in 2018 from $1,184,000 in 2017 and $1,172,000 in 2016. Loans sold balances are as follows:

$62 million (representing 489 loans) in 2018
$68 million (representing 536 loans) in 2017
$80 million (representing 566 loans) in 2016

First Mid Bank generally releases the servicing rights on loans sold into the secondary market.

- Revenue from ATMs and debit cards increased $992,000 or 15.3% to $7,487,000 in 2018 from $6,495,000 in 2017 and $6,004,000 in 2016. The increase in 2018 was primarily due to an increase in electronic transactions following the First Bank and Soy Capital Bank acquisition. The increases during 2017 were primarily due to an increase in electronic transactions following the acquisition of First Clover Leaf and quarterly incentives received from VISA.

- Bank owned life insurance decreased $249,000 or 15.2% to $1,389,000 in 2018 from $1,638,000 in 2017 and $671,000 in 2016. The decrease is primarily due to a death benefit of $511,000 that was received in 2017 that did not recur in 2018. The Company invested $25 million in bank owned life insurance during the first quarter of 2016, acquired $8.6 million in bank owned life insurance in the First Bank acquisition in 2018, and acquired $13.6 million in bank owned life insurance in the Soy Capital acquisition in 2018, and acquired $15.6 million in bank owned life insurance in the First Clover Leaf acquisition in 2016.

- Other income decreased $761,000 or 20.5% in 2018 to $2,945,000 from $3,706,000 in 2017 and $2,205,000 in 2016. The decrease was primarily due to income tax refunds received in 2017 resulting from overpayment of taxes in 2016 by First Clover Leaf Financial and a decline in loan late charges and closing fees resulting from less loan transaction activity. The increase from 2016 to 2017 is primarily due to income tax refunds resulting from overpayment of taxes in 2016 by First Clover Leaf Bank and increases in various loan fees.

Other Expense

The major categories of other expense include salaries and employee benefits, occupancy and equipment expenses and other operating expenses associated with day-to-day operations. The following table sets forth the major components of other expense for the last three years (in thousands):

				$ Change From Prior Year	
	2018	2017	2016	2018	2017
Salaries and benefits	$46,803	$39,756	$32,354	$7,047	$7,402
Occupancy and equipment	14,533	12,596	11,418	1,937	1,178
Other real estate owned, net	282	560	60	(278)	500
FDIC insurance assessment expense	1,059	905	966	154	(61)
Amortization of other intangibles	3,215	2,153	1,909	1,062	244
Stationery and supplies	963	724	815	239	(91)
Legal and professional fees	5,243	3,887	3,035	1,356	852
Marketing and promotion	1,794	1,356	1,845	438	(489)
Other	16,088	12,284	9,108	3,804	3,176
Total other expense	$89,980	$74,221	$61,510	$15,759	$12,711

Total non-interest expense increased to $90.0 million in 2018 from $74.2 million in 2017 and $61.5 million in 2016. The primary reasons for the more significant year-to-year changes in other expense components are as follows:

- Salaries and employee benefits, the largest component of other expense, increased $7.0 million or 17.7% to $46.8 million from $39.8 million in 2017, and $32.4 million in 2016. The increase is primarily due to the addition of 112 employees from the First Bank acquisition, the addition of 149 employees from the Soy Capital Bank acquisition and merit increases in 2018 for continuing employees during the first quarter of 2018. The increase in 2017 is primarily due to merit increases for continuing employees and a full year of expenses for the acquired First Clover Leaf employees. There were 818 full-time equivalent employees at December 31, 2018, compared to 592 at December 31, 2017, and 598 at December 31, 2016.

- Occupancy and equipment expense increased $1,937,000 or 15.4% to $14.5 million in 2018 from $12.6 million in 2017, and $11.4 million in 2016. The increase in 2018 was primarily due to increases in maintenance and repair expenses, rent expense, and building insurance related to the acquisition of First Bank and Soy Capital Bank. The increase in 2017 and 2016 was primarily due to increases in rent, property taxes, and depreciation expenses related to the acquisition of First Clover Leaf Bank during the third quarter of 2016.

- Net other real estate owned expense decreased $278,000 or 49.6% to $282,000 from $560,000 in 2017, and $60,000 in 2016. The decrease in 2018 was primarily due to more gains on properties sold during 2017 than properties sold in 2018. The increase in 2017 was primarily due to a write down of one property to the appraised value and real estate taxes and maintenance expenses on properties owned.

- FDIC insurance expense increased $154,000 or 17.0% to $1,059,000 from $905,000 in 2017, and $966,000 in 2016. The increase in 2018 was primarily due to an increase in average assets offset by a decline in FDIC rates. The decrease in 2017 was primarily due to a decline in FDIC rates.

- Amortization of other intangibles expense increased $1,062,000 or 49.3% to $3,215,000 from $2,153,000 in 2017, and $1,909,000 in 2016. The increase in 2018 was due to amortization of core deposit intangibles from the First Bank and Soy Capital acquisitions. The increase in 2017 was due to a full year of amortization of deposit premium for First Clover Leaf Bank.

- Other operating expenses increased $3,804,000 or 31.0% to $16,088,000 from $12,284,000 in 2017, and $9,108,000 in 2016. The increase in 2018 was primarily due to costs associated with the acquisition and merger of First Bank and the acquisition of Soy Capital Bank. The increase in 2017 was primarily due to additional expenses from First Clover Leaf locations and costs associated with the merger of First Clover Leaf Bank during the first quarter of 2017.

- On a net basis, all other categories of operating expenses increased $2,033,000 or 34.1% to $8,000,000 from $5,967,000 in 2017, and $5,695,000 in 2016. The increase is primarily due to an increase in legal and professional fees primarily associated with the acquisitions of First Bank and Soy Capital. The increase from 2016 to 2017 was primarily due to an increase in legal expenses, primarily due to acquisition and loan collection related expenses.

Income Taxes

Income tax expense amounted to $11,905,000 in 2018 compared to $15,042,000 in 2017, and $11,940,000 in 2016. Effective tax rates were 24.5% for 2018, 36.0% for 2017, and 35.3% for 2016. The decline in effective tax rate for 2018 compared to 2017 was primarily due to a change in federal statutory corporate tax rate from 35% to 21% effective January 1, 2018. The increases in tax expense and the effective tax rate for 2017 were primarily due to an increase in taxable income, and increase in Illinois corporate income tax rate from 7.75% to 9.50% effective July 1, 2017, and additional one-time income tax expense of approximately $1.4 million during the fourth quarter of 2017, due to remeasurement of deferred tax assets and liabilities because of the Tax Cut and Jobs Act.

The Company files U.S. federal and state of Illinois, Indiana, and Missouri income tax returns. The Company is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2015.

Analysis of Balance Sheets

Securities

The Company’s overall investment objectives are to insulate the investment portfolio from undue credit risk, maintain adequate liquidity, insulate capital against changes in market value and control excessive changes in earnings while optimizing investment performance. The types and maturities of securities purchased are primarily based on the Company’s current and projected liquidity and interest rate sensitivity positions. The following table sets forth the amortized cost of the available-for-sale and held-to-maturity securities for the last three years (dollars in thousands):

	December 31,								
	2018			2017			2016		
	Amortized Cost	Weighted Average Yield		Amortized Cost	Weighted Average Yield		Amortized Cost	Weighted Average Yield	
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$270,816	2.38	%	$185,128	1.98	%	$213,050	1.83	%
Obligations of states and political subdivisions	193,195	2.94	%	165,037	2.86	%	164,163	2.80	%
Mortgage-backed securities: GSE residential	304,372	2.86	%	295,778	2.59	%	318,829	2.57	%
Trust preferred securities	—	—	%	2,893	2.15	%	3,050	1.86	%
Other securities	2,278	3.58	%	2,039	2.50	%	4,034	2.14	%
Total securities	$770,661	2.72	%	$650,875	2.55	%	$703,126	2.39	%

At December 31, 2018, the amortized cost of the Company’s investment portfolio increased by $119.8 million from December 31, 2017 primarily due to securities that were added in the acquisitions of First Bank and Soy Capital, net of declines due to securities that were sold to provide cash flow to fund loans. At December 31, 2017, the amortized cost of the Company's investment portfolio decreased by $52.3 million from December 31, 2016 primarily due to securities that were sold to provide cash flow to fund loans.   When purchasing investment securities, the Company considers its overall liquidity and interest rate risk profile, as well as the adequacy of expected returns relative to the risks assumed.

The table below presents the credit ratings as of December 31, 2018 for certain investment securities (in thousands):

			Average Credit Rating of Fair Value at December 31, 2018 (1)					
	Amortized Cost	Estimated Fair Value	AAA	AA +/-	A +/-	BBB +/-	< BBB -	Not rated
Available-for-sale:								
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$201,380	$198,649	$—	$198,649	$—	$—	$ —	$—
Obligations of state and political subdivisions	193,195	192,579	18,923	118,627	51,753	495	—	2,781
Mortgage-backed securities (2)	304,372	298,672	1,017	—	—	—	—	297,655
Trust preferred securities	—	—	—	—	—	—	—	—
Other securities	2,278	2,374	—	—	—	2,010	—	364
Total investments	$701,225	$692,274	$19,940	$317,276	$51,753	$2,505	$ —	$300,800
Held-to-maturity:								
	$69,436	$67,909	$—	$67,909				$—

U.S. Treasury securities and obligations of
U.S. government corporations and
agencies

(1) Credit ratings reflect the lowest current rating assigned by a nationally recognized credit rating agency.

(2) Mortgage-backed securities include mortgage-backed securities (MBS) and collateralized mortgage obligation (CMO) issues from the following government sponsored enterprises: FHLMC, FNMA, GNMA and FHLB. While MBS and CMOs are no longer explicitly rated by credit rating agencies, the industry recognizes that they are backed by agencies which have an implied government guarantee.

Other-than-temporary Impairment of Securities

Declines in the fair value, or unrealized losses, of all available for sale investment securities, are reviewed to determine whether the losses are either a temporary impairment or OTTI. Temporary adjustments are recorded when the fair value of a security fluctuates from its historical cost. Temporary adjustments are recorded in accumulated other comprehensive income, and impact the Company's equity position. Temporary adjustments do not impact net income. A recovery of available for sale security prices also is recorded as an adjustment to other comprehensive income for securities that are temporarily impaired, and results in a positive impact to the Company's equity position.

OTTI is recorded when the fair value of an available for sale security is less than historical cost, and it is probable that all contractual cash flows will not be collected. Investment securities are evaluated for OTTI on at least a quarterly basis. In conducting this assessment, the Company evaluates a number of factors including, but not limited to:

- how much fair value has declined below amortized cost;
- how long the decline in fair value has existed;
- the financial condition of the issuers;
- contractual or estimated cash flows of the security;
- underlying supporting collateral;
- past events, current conditions and forecasts;
- significant rating agency changes on the issuer; and
- the Company's intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.

If the Company intends to sell the security or if it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis, the entire amount of OTTI is recorded to noninterest income, and therefore, results in a negative impact to net income. Because the available for sale securities portfolio is recorded at fair value, the conclusion as to whether an investment decline is other-than-temporarily impaired, does not significantly impact the Company's equity position, as the amount of the temporary adjustment has already been reflected in accumulated other comprehensive income/loss. If the Company does not intend to sell the security and it is not more-likely-than-not it will be required to sell the security before recovery of its amortized cost basis, only the amount related to credit loss is recognized in earnings. In determining the portion of OTTI that is related to credit loss, the Company compares the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. The remaining portion of OTTI, related to other factors, is recognized in other comprehensive earnings, net of applicable taxes. The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. See Note 4 -- Investment Securities in the notes to the financial statements for a discussion of the Company's evaluation and, when applicable, charges for OTTI.

Loans

The loan portfolio (net of unearned interest) is the largest category of the Company's earning assets. The following table summarizes the composition of the loan portfolio, including loans held for sale, for the last five years (in thousands):

	2018	% Outstanding Loans		2017	2016	2015	2014
Construction and land development	$50,619	1.9	%	$107,594	$49,104	$39,209	$21,627
Farm loans	231,700	8.8	%	127,183	126,108	122,474	110,193

1-4 Family residential properties	373,518	14.1	%	293,667	326,415	231,571	181,921
Multifamily residential properties	184,051	7.0	%	61,798	83,200	45,740	53,129
Commercial real estate	906,850	34.2	%	681,757	630,135	409,172	379,604
Loans secured by real estate	1,746,738	66.0	%	1,271,999	1,214,962	848,166	746,474
Agricultural loans	135,877	5.1	%	86,631	86,685	75,886	68,298
Commercial and industrial loans	557,011	21.1	%	444,263	409,033	305,060	223,780
Consumer loans	91,516	3.5	%	29,749	38,028	41,579	15,118
All other loans	113,377	4.3	%	106,859	77,284	11,198	8,736
Total loans	$2,644,519	100.0	%	$1,939,501	$1,825,992	$1,281,889	$1,062,406

Loan balances increased by $705.0 million or 36.4% from December 31, 2017 to December 31, 2018 primarily due to loans acquired from First Bank and Soy Capital Bank. Loan balances increased by $113.5 million or 6.2% from December 31, 2016 to December 31, 2017 primarily due to increases in construction and land development, commercial operating, and commercial real estate loans. The balances of loans sold into the secondary market were $62.3 million in 2018 compared to $67.5 million in 2017. The balance of real estate loans held for sale, included in the balances shown above, amounted to $1,508,000 and $1,025,000 as of December 31, 2018 and 2017, respectively.

Commercial and commercial real estate loans generally involve higher credit risks than residential real estate and consumer loans. Because payments on loans secured by commercial real estate or equipment are often dependent upon the successful operation and management of the underlying assets, repayment of such loans may be influenced to a great extent by conditions in the market or the economy. The Company does not have any sub-prime mortgages or credit card loans outstanding which are also generally considered to be higher credit risk.

The following table summarizes the loan portfolio geographically by branch region as of December 31, 2018 and 2017 (dollars in thousands):

	December 31, 2018			December 31, 2017		
	Principal balance	% Outstanding Loans		Principal balance	% Outstanding Loans	
Central region	$571,909	21.7	%	$543,938	28.0	%
Sullivan region	375,407	14.2	%	167,977	8.7	%
Decatur region	501,743	19.0	%	378,867	19.5	%
Peoria region	291,283	11.0	%	189,639	9.8	%
Highland region	518,881	19.6	%	525,983	27.1	%
Southern region	133,225	5.0	%	133,097	6.9	%
Soy Capital Bank	252,071	9.5	%	—	—	%
Total all regions	$2,644,519	100.0	%	$1,939,501	100.0	%

Loans are geographically dispersed among these regions located in central and southwestern Illinois. While these regions have experienced some economic stress during 2018 and 2017, the Company does not consider these locations high risk areas since these regions have not experienced the significant volatility in real estate values seen in some other areas in the United States.

The Company does not have a concentration, as defined by the regulatory agencies, in construction and land development loans or commercial real estate loans as a percentage of total risk-based capital for the periods shown above. At December 31, 2018 and 2017, the Company did have industry loan concentrations in excess of 25% of total risk-based capital in the following industries (dollars in thousands):

	December 31, 2018			December 31, 2017		
	Principal balance	% Outstanding Loans		Principal balance	% Outstanding Loans	
Other grain farming	$276,142	10.44	%	$170,758	8.80	%
Lessors of non-residential buildings	250,495	9.47	%	185,967	9.59	%
Lessors of residential buildings & dwellings	289,169	10.93	%	131,756	6.79	%
Hotels and motels	129,216	4.89	%	131,702	6.79	%
Other Gambling Industries	105,259	3.98	%	95,713	4.93	%

The Company had no further industry loan concentrations in excess of 25% of total risk-based capital.

The following table presents the balance of loans outstanding as of December 31, 2018, by contractual maturities (in thousands):

	Maturity (1)			
	One year or less(2)	Over 1 through 5 years	Over 5 years	Total
Construction and land development	$29,636	$9,836	$11,147	$50,619
Farm loans	10,472	76,472	144,756	231,700
1-4 Family residential properties	28,985	82,628	261,905	373,518
Multifamily residential properties	11,380	126,850	45,821	184,051

Commercial real estate	87,732	369,957	449,161	906,850
Loans secured by real estate	168,205	665,743	912,790	1,746,738
Agricultural loans	104,746	27,121	4,010	135,877
Commercial and industrial loans	218,470	281,843	56,698	557,011
Consumer loans	5,288	74,996	11,232	91,516
All other loans	12,468	33,052	67,857	113,377
Total loans	$509,177	$1,082,755	$1,052,587	$2,644,519

(1) Based upon remaining contractual maturity.
(2) Includes demand loans, past due loans and overdrafts.

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As of December 31, 2018, loans with maturities over one year consisted of approximately $1.6 billion in fixed rate loans and approximately $557 million in variable rate loans. The loan maturities noted above are based on the contractual provisions of the individual loans. The Company has no general policy regarding renewals and borrower requests, which are handled on a case-by-case basis.

Nonperforming Loans and Nonperforming Other Assets

Nonperforming loans include: (a) loans accounted for on a nonaccrual basis; (b) accruing loans contractually past due ninety days or more as to interest or principal payments; and (c) loans not included in (a) and (b) above which are defined as “troubled debt restructurings”. Repossessed assets include primarily repossessed real estate and automobiles.

The Company’s policy is to discontinue the accrual of interest income on any loan for which principal or interest is ninety days past due. The accrual of interest is discontinued earlier when, in the opinion of management, there is reasonable doubt as to the timely collection of interest or principal. Once interest accruals are discontinued, accrued but uncollected interest is charged against current year income. Subsequent receipts on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal.

Restructured loans are loans on which, due to deterioration in the borrower’s financial condition, the original terms have been modified in favor of the borrower or either principal or interest has been forgiven. Repossessed assets represent property acquired as the result of borrower defaults on loans. These assets are recorded at estimated fair value, less estimated selling costs, at the time of foreclosure or repossession. Write-downs occurring at foreclosure are charged against the allowance for loan losses. On an ongoing basis, properties are appraised as required by market indications and applicable regulations. Write-downs for subsequent declines in value are recorded in non-interest expense in other real estate owned along with other expenses related to maintaining the properties.

The following table presents information concerning the aggregate amount of nonperforming loans and repossessed assets (in thousands):

	December 31,				
	2018	2017	2016	2015	2014
Nonaccrual loans	$27,298	$16,659	$12,053	$3,412	$4,105
Restructured loans which are performing in accordance with revised terms	2,451	854	6,185	601	435
Total nonperforming loans	29,749	17,513	18,238	4,013	4,540
Repossessed assets	2,595	2,834	1,985	478	263
Total nonperforming loans and repossessed assets	$32,344	$20,347	$20,223	$4,491	$4,803
Nonperforming loans to loans, before allowance for loan losses	1.12 %	0.90 %	1.00 %	0.31 %	0.43 %
Nonperforming loans and repossessed assets to loans, before allowance for loan losses	1.22 %	1.05 %	1.11 %	0.35 %	0.45 %

The $10.6 million increase in nonaccrual loans during 2018 resulted from the net of $14.7 million of loans put on nonaccrual status including $2,242,000 acquired from First Bank and $344,000 acquired from Soy Capital Bank, offset by $235,000 of loans transferred to other real estate owned, $564,000 of loans charged off and $3.3 million of loans becoming current or paid-off. The amounts above do not include loans formerly identified as TDRs by Soy Capital Bank. The following table summarizes the composition of nonaccrual loans (in thousands):

	December 31, 2018		December 31, 2017	
	Balance	% of Total	Balance	% of Total
Construction and land development	$377	1.4 %	$—	— %
Farm loans	309	1.1 %	291	1.7 %
1-4 Family residential properties	5,762	21.1 %	2,687	16.1 %
Multifamily residential properties	2,105	7.7 %	368	2.2 %
Commercial real estate	8,457	31.1 %	5,596	33.6 %
Loans secured by real estate	17,010	62.4 %	8,942	53.6 %
Agricultural loans	667	2.4 %	757	4.5 %
Commercial and industrial loans	8,990	32.9 %	6,658	40.1 %
Consumer loans	625	2.3 %	302	1.8 %
All Other loans	6	— %	—	— %
Total loans	$27,298	100.0%	$16,659	100.0%

Interest income that would have been reported if nonaccrual and restructured loans had been performing totaled $1,189,000, $471,000 and $133,000 for the years ended December 31, 2018, 2017 and 2016, respectively.

The $239,000 decrease in repossessed assets during 2018 resulted from the net of $619,000 of additional assets repossessed, $1,408,000 assets acquired,$1,729,000 of repossessed assets sold and $537,000 of further write-downs of repossessed assets to current market value. The following table summarizes the composition of repossessed assets (in thousands):

	December 31, 2018		December 31, 2017	
	Balance	% of Total	Balance	% of Total
Construction and land development	$1,513	58.2 %	$1,781	62.7 %
Farm Loans	—	— %	—	— %
1-4 family residential properties	583	22.5 %	413	14.6 %
Multi-family residential properties	—	— %	—	— %
Commercial real estate	438	16.9 %	560	19.8 %
Total real estate	2,534	97.6 %	2,754	97.1 %
Agricultural Loans	—	— %	—	— %
Commercial & Industrial Loans	61	2.4 %	44	1.6 %
Consumer Loans	—	— %	36	1.3 %
Total repossessed collateral	$2,595	100.0%	$2,834	100.0%

Repossessed assets sold during 2018 resulted in net losses of $132,000, of which $120,000 of net losses was related to real estate asset sales and $12,000 of net losses was related to other repossessed assets.

Loan Quality and Allowance for Loan Losses

The allowance for loan losses represents management's estimate of the reserve necessary to adequately account for probable losses existing in the current portfolio. The provision for loan losses is the charge against current earnings that is determined by management as the amount needed to maintain an adequate allowance for loan losses. In determining the adequacy of the allowance for loan losses, and therefore the provision to be charged to current earnings, management relies predominantly on a disciplined credit review and approval process that extends to the full range of the Company's credit exposure. The review process is directed by overall lending policy and is intended to identify, at the earliest possible stage, borrowers who might be facing financial difficulty. Once identified, the magnitude of exposure to individual borrowers is quantified in the form of specific allocations of the allowance for loan losses. Management considers collateral values and guarantees in the determination of such specific allocations. Additional factors considered by management in evaluating the overall adequacy of the allowance include historical net loan losses, the level and composition of nonaccrual, past due and renegotiated loans, trends in volumes and terms of loans, effects of changes in risk selection and underwriting standards or lending practices, lending staff changes, concentrations of credit, industry conditions and the current economic conditions in the region where the Company operates.

Given the current state of the economy, management did assess the impact of the recession on each category of loans and adjusted historical loss factors for more recent economic trends. Management utilizes a five-year loss history as one of several components in assessing the probability of inherent future losses. Given the continued weakened economic conditions, management also increased its allocation to various loan categories for economic factors during 2015 and 2014. Some of the economic factors include the potential for reduced cash flow for commercial operating loans from reduction in sales or increased operating costs, decreased occupancy rates for commercial buildings, reduced levels of home sales for commercial land developments, the uncertainty regarding grain prices, drought conditions and increased operating costs for farmers, and increased levels of unemployment and bankruptcy impacting consumer’s ability to pay. Each of these economic uncertainties was taken into consideration in developing the level of the reserve. Management considers the allowance for loan losses a critical accounting policy.

Management recognizes there are risk factors that are inherent in the Company’s loan portfolio. All financial institutions face risk factors in their loan portfolios because risk exposure is a function of the business. The Company’s operations (and therefore its loans) are concentrated in central and southern Illinois, an area where agriculture is the dominant industry. Accordingly, lending and other business relationships with agriculture-based businesses are critical to the Company’s success. At December 31, 2018, the Company’s loan portfolio included $367.6 million of loans to borrowers whose businesses are directly related to agriculture. Of this amount, $276.1 million was concentrated in other grain farming. Total loans to borrowers whose businesses are directly related to agriculture increased $153.8 million from $213.8 million at December 31, 2017 while loans concentrated in other grain farming increased $105.3 million from $170.8 million at December 31, 2017.

While the Company adheres to sound underwriting practices, including collateralization of loans, any extended period of low commodity prices, drought conditions, significantly reduced yields on crops and/or reduced levels of government assistance to the agricultural industry could result in an increase in the level of problem agriculture loans and potentially result in loan losses within the agricultural portfolio.

In addition, the Company has $129.2 million of loans to motels and hotels. The performance of these loans is dependent on borrower specific issues as well as the general level of business and personal travel within the region. While the Company adheres to sound underwriting standards, a prolonged period of reduced business or personal travel could result in an increase in nonperforming loans to this business segment and potentially in loan losses. The Company also has $250.5 million of loans to lessors of non-residential buildings and $289.2 million of loans to lessors of residential buildings and dwellings, and $105.3 million to other gambling industries.

The structure of the Company's loan approval process is based on progressively larger lending authorities granted to individual loan officers, loan committees, and ultimately the Board of Directors. Outstanding balances to one borrower or affiliated borrowers are limited by federal regulation; however, limits well below the regulatory thresholds are generally observed. The vast majority of the Company's loans are to businesses located in the geographic market areas served by the Company's branch bank system. Additionally, a significant portion of the collateral securing the loans in the portfolio is located within the Company's primary geographic footprint. In general, the Company adheres to loan underwriting standards consistent with industry guidelines for all loan segments.

The Company minimizes credit risk by adhering to sound underwriting and credit review policies. Management and the Board of Directors of the Company review these policies at least annually. Senior management is actively involved in business development efforts and the maintenance and monitoring of credit underwriting and approval. The loan review system and controls are designed to identify, monitor and address asset quality problems in an accurate and timely manner. On a quarterly basis, the Board of Directors and management review the status of problem loans and determine a best estimate of the allowance. In addition to internal policies and controls, regulatory authorities periodically review asset quality and the overall adequacy of the allowance for loan losses.

Analysis of the allowance for loan losses for the past five years and of changes in the allowance for these periods is summarized as follows (dollars in thousands):

	2018		2017		2016		2015		2014	
Average loans outstanding, net of unearned income	$2,276,500		$1,836,617		$1,454,591		$1,126,479		$1,022,605	
Allowance-beginning of period	19,977		16,753		14,576		13,682		13,249	
Charge-offs:										
Real estate-mortgage	1,281		1,025		381		131		185	
Commercial, financial & agricultural	925		3,649		630		222		41	
Installment	364		98		292		285		63	
Other	423		423		372		268		248	
Total charge-offs	2,993		5,195		1,675		906		537	
Recoveries:										
Real estate-mortgage	91		406		529		186		110	
Commercial, financial & agricultural	133		281		283		120		78	
Installment	80		27		25		24		26	
Other	234		243		189		152		127	
Total recoveries	538		957		1,026		482		341	
Net charge-offs	2,455		4,238		649		424		196	
Provision for loan losses	8,667		7,462		2,826		1,318		629	
Allowance-end of period	$26,189		$19,977		$16,753		$14,576		$13,682	
Ratio of annualized net charge-offs to average loans	0.11	%	0.23	%	0.05	%	0.04	%	0.03	%
Ratio of allowance for loan losses to loans outstanding (less unearned interest at end of period)	0.99	%	1.03	%	0.92	%	1.14	%	1.29	%
Ratio of allowance for loan losses to nonperforming loans	88.0	%	114.1	%	92.0	%	363.0	%	301.4	%

The ratio of the allowance for loan losses to nonperforming loans is 88.0% as of December 31, 2018 compared to 114.1% as of December 31, 2017. The decrease in this ratio is primarily due to the increase in loan balances and the increase in non performing loans to $29.7 million at December 31, 2018 from $17.5 million at December 31, 2017 including $.3 million in non-performing loans from Soy Capital Bank and $6.6 million in non-performing loans acquired from First Bank during the second quarter of 2018. The amounts above do not include loans formerly identified as TDRs by Soy Capital Bank. Management believes that the overall estimate of the allowance for loan losses appropriately accounts for probable losses attributable to current exposures.

During 2018, the Company had net charge-offs of $2,455,000 compared to $4,238,000 in 2017. During 2018, there were significant charge offs of commercial real estate loans to one borrower of $169,000, charge offs of two agricultural loans to one borrower of $93,000, and charge offs of six commercial operating loans to two borrowers of $540,000. During 2017, the Company had net charge-offs of $4,238,000 compared to $649,000 in 2016. During 2017, there were significant charge offs of commercial real estate loans to three borrowers of $619,000, charge offs of two agricultural loans to one borrower of $662,000, and charge offs of twelve commercial operating loans to five borrowers of $2,689,000.

At December 31, 2018, the allowance for loan losses amounted to $26.2 million or 0.99% of total loans. At December 31, 2017, the allowance for loan losses amounted to $20.0 million or 1.03% of total loans. The decrease in this ratio in 2018 is primarily due to an increase in loan balances. The increase in this ratio in 2017 is primarily due to an increase in provision recorded as loans acquired renewed or paid off.

The allowance is allocated to the individual loan categories by a specific allocation for all classified loans plus a percentage of loans not classified based on historical losses and other factors. The allowance for loan losses, in management's judgment, is allocated as follows to cover probable loan losses (dollars in thousands):

December 31, 2018		December 31, 2017		December 31, 2016
Allowance for loan losses	% of loans to total loans	Allowance for loan losses	% of loans to total loans	