FIRST MIDWEST BANCORP INC
Form 10-Q
August 08, 2008

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

FORM 10-Q

(Mark One)

[X]	Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended **June 30, 2008**
	or
[ ]	Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from _________ to __________.

Commission File Number 0-10967

FIRST MIDWEST BANCORP, INC.

(Exact name of Registrant as specified in its charter)

Delaware	36-3161078
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

One Pierce Place, Suite 1500
Itasca, Illinois 60143-9768

(Address of principal executive offices) (zip code)

Registrant's telephone number, including area code: **(630) 875-7450**

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ].

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

As of August 8, 2008, there were 48,583,113 shares of $.01 par value common stock outstanding.

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FIRST MIDWEST BANCORP, INC.

FORM 10-Q

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First Midwest Bancorp, Inc. is a bank holding company headquartered in the Chicago suburb of Itasca, Illinois with operations throughout the greater Chicago metropolitan area as well as central and western Illinois. Our principal subsidiary is First Midwest Bank, which provides a broad range of commercial and retail banking services to consumer, commercial and industrial, and public or governmental customers. We are committed to meeting the financial needs of the people and businesses in the communities where we live and work by providing customized banking solutions, quality products, and innovative services that truly fulfill those financial needs.

AVAILABLE INFORMATION

We file annual, quarterly, and current reports, proxy statements, and other information with the Securities and Exchange Commission ("SEC"), and we make this information available free of charge on or through the investor relations section of our web site at *www.firstmidwest.com/aboutinvestor_overview.asp*. The following documents are also posted on our web site or are available in print upon the request of any stockholder to our Corporate Secretary:

* Certificate of Incorporation
* Company By-laws
* Charters for our Audit, Compensation, and Nominating and Corporate Governance Committees

* Related Person Transaction Policies and Procedures

* Corporate Governance Guidelines

* Code of Ethics and Standards of Conduct (the "Code"), which governs our directors, officers, and employees

* Code of Ethics for Senior Financial Officers.

Within the time period required by the SEC and the Nasdaq Stock Market, we will post on our web site any amendment to the Code and any waiver applicable to any executive officer, director, or senior financial officer (as defined in the Code). In addition, our web site includes information concerning purchases and sales of our securities by our executive officers and directors, as well as any disclosure relating to certain non-GAAP financial measures (as defined in the SEC's Regulation G) that we may make public orally, telephonically, by webcast, by broadcast, or by similar means from time to time.

Our Corporate Secretary can be contacted by writing to First Midwest Bancorp, Inc., One Pierce Place, Itasca, Illinois 60143, Attn: Corporate Secretary. The Company's Investor Relations Department can be contacted by telephone at (630) 875-7463 or by e-mail at *investor.relations@firstmidwest.com*.

CAUTIONARY STATEMENT PURSUANT TO THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

We include or incorporate by reference in this Quarterly Report on Form 10-Q, and from time to time our management may make, statements that may constitute "forward-looking statements" within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are not historical facts, but instead represent only management's beliefs regarding future events, many of which, by their nature, are inherently uncertain and outside our control. Although we believe the expectations reflected in any forward-looking statements are reasonable, it is possible that our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in such statements. In some cases, you can identify these statements by forward-looking words such as "may," "might," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," or "continue," and the negative of these terms and other comparable terminology. We caution you not to place undue reliance on forward-looking statements, which speak only as of the date of this report, or when made.

Forward-looking statements are subject to known and unknown risks, uncertainties, and assumptions and may include projections relating to our future financial performance including our growth strategies and anticipated trends in our business. For a detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements, you should refer to our Annual Report on Form 10-K for the year ended December 31, 2007, including the sections entitled "Risk Factors" and "Management's Discussion and Analysis of Results of Operations," as well as our subsequent periodic and current reports filed with the SEC. These risks and uncertainties are not exhaustive however. Other sections of this report describe additional factors that could adversely impact our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible to predict all risks and uncertainties, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. We are under no duty to update any of these forward-looking statements after the date of this report to conform our prior statements to actual results or revised expectations, and we do not intend to do so.

PART 1. FINANCIAL INFORMATION (Unaudited)

ITEM 1. FINANCIAL STATEMENTS

FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Amounts in thousands)

	June 30, 2008 (Unaudited)	December 31, 2007
Assets		
Cash and due from banks	$ 174,122	$ 193,792
Federal funds sold and other short-term investments	692	1,045
Mortgages held for sale	-	394
Trading account securities	17,368	18,352
Securities available-for-sale, at fair value	2,106,461	2,080,046
Securities held-to-maturity, at amortized cost	94,580	97,671
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	54,767	54,767
Loans	5,182,355	4,963,672
Reserve for loan losses	(66,104)	(61,800)
Net loans	5,116,251	4,901,872
Premises, furniture, and equipment	121,215	125,828
Accrued interest receivable	44,504	48,971
Investment in bank owned life insurance	206,132	203,535
Goodwill	262,886	262,195
Other intangible assets	23,851	26,040
Other assets	88,196	77,010
Total assets	$ 8,311,025	$ 8,091,518
Liabilities		
Demand deposits	$ 1,077,659	1,064,684
Savings deposits	809,625	798,361
NOW accounts	977,553	889,760
Money market deposits	820,139	829,226
Time deposits	2,100,187	2,196,830
Total deposits	5,785,163	5,778,861
Borrowed funds	1,489,908	1,264,228
Subordinated debt	232,476	230,082
Accrued interest payable	11,663	16,843
Other liabilities	67,781	77,529
Total liabilities	7,586,991	7,367,543
Stockholders' Equity		
Preferred stock, no par value; 1,000 shares authorized, none issued	-	-
Common stock, $.01 par value; authorized 100,000 shares; issued 61,326 shares; outstanding: June 30, 2008 - 48,584 shares	613	613

December 31, 2007 - 48,453 shares		
Additional paid-in capital	206,113	207,851
Retained earnings	866,844	844,972
Accumulated other comprehensive loss, net of tax	(35,949)	(11,727)
Treasury stock, at cost: June 30, 2008 - 12,742 shares		
December 31, 2007 - 12,873 shares	(313,587)	(317,734)
Total stockholders' equity	724,034	723,975
Total liabilities and stockholders' equity	$ 8,311,025	$ 8,091,518

See accompanying notes to unaudited consolidated financial statements.

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FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME

(Amounts in thousands, except per share data)
(Unaudited)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Interest Income				
Loans	$ 74,819	$ 92,273	$ 156,153	$ 184,352
Securities available-for-sale	24,845	26,266	50,435	53,723
Securities held-to-maturity	1,160	1,296	2,290	2,449
Federal Home Loan Bank and Federal Reserve Bank stock	332	544	670	1,171
Federal funds sold and other short-term investments	157	292	240	565
Total interest income	101,313	120,671	209,788	242,260
Interest Expense				
Deposits	28,036	41,593	62,246	83,720
Borrowed funds	9,249	14,363	21,325	29,712
Subordinated debt	3,702	3,751	7,391	7,494
Total interest expense	40,987	59,707	90,962	120,926
Net interest income	60,326	60,964	118,826	121,334
Provision for loan losses	5,780	1,761	14,840	4,721
Net interest income after provision for loan losses	54,546	59,203	103,986	116,613
Noninterest Income				
Service charges on deposit accounts	11,385	11,483	21,807	21,070
Trust and investment advisory fees	3,945	3,916	7,892	7,706

Other service charges, commissions, and fees	4,456	6,099	9,458	11,258
Card-based fees	4,236	4,181	8,134	7,892
Bank owned life insurance income	2,145	1,982	4,607	3,893
Securities (losses) gains, net	(4,618)	961	350	4,405
Other income	874	2,001	194	3,099
Total noninterest income	22,423	30,623	52,442	59,323
Noninterest Expense				
Salaries and wages	20,143	22,656	39,167	43,459
Retirement and other employee benefits	6,225	6,352	13,391	13,099
Net occupancy expense	5,528	5,386	11,679	10,888
Equipment expense	2,451	2,590	5,018	5,216
Technology and related costs	1,820	1,849	3,591	3,557
Professional services	2,611	2,219	4,905	4,321
Advertising and promotions	1,713	1,541	2,750	2,553
Merchant card expense	1,780	1,728	3,426	3,278
Other expenses	7,674	6,416	15,361	12,521
Total noninterest expense	49,945	50,737	99,288	98,892
Income before income tax expense	27,024	39,089	57,140	77,044
Income tax expense	27	9,778	5,105	18,704
Net income	$ 26,997	$ 29,311	$ 52,035	$ 58,340
Per Share Data				
Basic earnings per share	$ 0.56	$ 0.59	$ 1.07	$ 1.17
Diluted earnings per share	$ 0.56	$ 0.59	$ 1.07	$ 1.16
Cash dividends per share	$ 0.310	$ 0.295	$ 0.620	$ 0.590
Weighted average shares outstanding	48,459	49,617	48,446	49,768
Weighted average diluted shares outstanding	48,576	49,984	48,582	50,152

See accompanying notes to unaudited consolidated financial statements.

FIRST MIDWEST BANCORP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Amounts in thousands, except per share data)

(Unaudited)

	Common Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Treasury Stock	Total
Balance at January 1, 2007	50,025	$ 613	$ 205,044	$ 823,787	$ (15,288)	$ (263,142)	$ 751,014
Cumulative-effect for change in accounting for purchases of life insurance policies	-	-	-	(209)	-	-	(209)
Adjusted balance at January 1, 2007	50,025	613	205,044	823,578	(15,288)	(263,142)	750,805
Comprehensive Income:							
Net income	-	-	-	58,340	-	-	58,340
Other comprehensive loss: (1)							
Unrealized losses on securities	-	-	-	-	(19,847)	-	(19,847)
Other activities	-	-	-	-	(13)	-	(13)
Total comprehensive income	-						38,480
Dividends declared ($0.59 per share)	-	-	-	(29,320)	-	-	(29,320)
Purchase of treasury stock	(678)	-	-	-	-	(25,166)	(25,166)
Share-based compensation expense	-	-	1,808	-	-	-	1,808
Exercise of stock options and restricted stock activity	150	-	(1,021)	-	-	5,578	4,557

Treasury stock (purchased for) issued to benefit plans	(3)	-	5	-	-	(109)	(104)
Balance at June 30, 2007	49,494	$ 613	$ 205,836	$ 852,598	$ (35,148)	$ (282,839)	$ 741,060
Balance at January 1, 2008	48,453	$ 613	$ 207,851	$ 844,972	$ (11,727)	$ (317,734)	$ 723,975
Comprehensive Income:							
Net income	-	-	-	52,035	-	-	52,035
Other comprehensive loss: (1)							
Unrealized losses on securities	-	-	-	-	(24,222)	-	(24,222)
Total comprehensive income							27,813
Dividends declared ($0.62 per share)	-	-	-	(30,163)	-	-	(30,163)
Purchase of treasury stock	(5)	-	-	-	-	(138)	(138)
Share-based compensation expense	-	-	1,774	-	-	-	1,774
Exercise of stock options and restricted stock activity	138	-	(3,511)	-	-	4,337	826
Treasury stock (purchased for) issued to benefit plans	(2)	-	(1)	-	-	(52)	(53)
Balance at June 30, 2008	48,584	$ 613	$ 206,113	$ 866,844	$ (35,949)	$ (313,587)	$ 724,034

(1) Net of taxes and reclassification adjustments.

See accompanying notes to unaudited consolidated financial statements.

FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollar amounts in thousands)
(Unaudited)

	Six Months Ended June 30,	
	2008	2007
Net cash provided by operating activities	$ 69,536	$ 51,771
Investing Activities		
Securities available-for-sale:		
Proceeds from maturities, repayments, and calls	171,485	155,518
Proceeds from sales	220,124	147,826
Purchases	(456,461)	(71,594)
Securities held-to-maturity:		
Proceeds from maturities, repayments, and calls	30,388	16,289
Purchases	(27,252)	(28,994)
Net (increase) decrease in loans	(233,228)	90,556
Proceeds from claims on bank owned life insurance	2,010	886
Proceeds from sales of other real estate owned	2,280	3,050
Proceeds from sales of premises, furniture, and equipment	720	572
Purchases of premises, furniture, and equipment	(1,712)	(8,091)
Net cash (used in) provided by investing activities	(291,646)	306,018
Financing Activities		
Net increase (decrease) in deposit accounts	6,302	(352,472)
Net increase (decrease) in borrowed funds	225,680	(10,078)
Purchases of treasury stock	(138)	(25,166)
Proceeds from issuance of treasury stock	(53)	-
Cash dividends paid	(30,122)	(29,476)
Exercise of stock options and restricted stock activity	435	3,791
Excess tax benefit from exercise of stock options and release of restricted stock awards	(17)	342
Net cash provided by (used in) financing activities	202,087	(413,059)

Net decrease in cash and cash equivalents	(20,023)	(55,270)
Cash and cash equivalents at beginning of period	194,837	214,906
Cash and cash equivalents at end of period	$ 174,814	$ 159,636
Supplemental Disclosures:		
Noncash transfers of loans to foreclosed real estate	$ 4,009	$ 3,830
Dividends declared but unpaid	15,086	14,623

See accompanying notes to unaudited consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated interim financial statements of First Midwest Bancorp, Inc. (the "Company"), a Delaware corporation, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for quarterly reports on Form 10-Q and do not include certain information and footnote disclosures required by U.S. generally accepted accounting principles ("GAAP") for complete annual financial statements. Accordingly, these financial statements should be read in conjunction with the Company's 2007 Annual Report on Form 10-K ("2007 10-K").

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with U.S. GAAP and reflect all adjustments that are, in the opinion of management, necessary for the fair presentation of the financial position and results of operations for the periods presented. All such adjustments are of a normal recurring nature. The results of operations for the quarter and six months ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

The consolidated financial statements include the accounts and results of operations of the Company and its subsidiaries after elimination of all significant intercompany accounts and transactions. Certain reclassifications have been made to prior year amounts to conform to the current year presentation. U.S. GAAP requires management to make certain estimates and assumptions. Although these and other estimates and assumptions are based on the best available information, actual results could be materially different from these estimates.

2. RECENT ACCOUNTING PRONOUNCEMENTS

Fair Value Measurements:

Effective January 1, 2008, the Company adopted Financial Accounting Standards Board ("FASB") Statement No. 157, *Fair Value Measurements* ("SFAS No. 157"), which, upon adoption, replaced various definitions of fair value in existing accounting literature with a single definition, established a framework for measuring fair value, and required additional disclosures about fair value measurements. SFAS No. 157 applies whenever an entity is measuring fair value under other accounting standards that require or permit fair value measurement. Although SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, the FASB provided a one-year deferral for implementation for non-financial assets and liabilities. The adoption of SFAS No. 157 on January 1, 2008 did not have a material impact on the Company's financial position, results of operations, or liquidity. Refer to Note 9, "Fair Value," for the Company's fair value measurement disclosures.

Fair Value Option

: Effective January 1, 2008, the Company adopted FASB Statement No. 159, *The Fair Value Option for Financial Assets and Liabilities* ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure certain financial assets and liabilities at fair value that are not currently required to be measured at fair value. The fair value option is applied on an instrument-by-instrument basis, is irrevocable and can only be applied to an entire instrument and not to specified risks, specified cash flows, or portions of that instrument. Changes in fair value (i.e. unrealized gains and losses) on items for which the fair value option has been elected will be reported in earnings at each subsequent reporting date and upfront fees and costs related to those items will be recognized in earnings as incurred and not deferred. SFAS No. 159 also requires entities to provide additional information that would help users of the financial statements understand how changes in fair values affect current-period earnings. While the Company did not elect the fair value option on the adoption date, it may elect this guidance for financial assets and liabilities in the future as permitted under the statement. Accordingly, the adoption of SFAS No. 159 on January 1, 2008 did not have an impact on the Company's financial position, results of operations, or liquidity.

Endorsement Split-Dollar Life Insurance Arrangements:

Effective January 1, 2008, the Company adopted Emerging Issues Task Force ("EITF") Issue 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* ("EITF 06-4"). The EITF is limited to the recognition of a liability and related compensation costs for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods. The effect of initially applying the guidance would be accounted for as a cumulative-effect adjustment to beginning retained earnings with the option of retrospective application. As the Company had already followed the provisions of this statement, the adoption of EITF 06-4 on January 1, 2008 did not have an impact on the Company's financial position, results of operations, or liquidity.

Business Combinations:

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* ("SFAS No. 141(R)"). SFAS No. 141(R) will significantly change how entities apply the acquisition method to business combinations. The most significant changes affecting how the Company will account for business combinations under this statement

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include: the acquisition date will be the date the acquirer obtains control; all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; acquisition-related restructuring costs that do not meet the criteria in SFAS No.146, *Accounting for Costs Associated with Exit or Disposal Activities*, will be expensed as incurred; transaction costs will be expensed as incurred, except for debt or equity issuance costs which will be accounted for in accordance with other generally accepted accounting principles; reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. In addition, SFAS No. 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward. The Company will be required to prospectively apply SFAS No. 141(R) to all business combinations completed on or after January 1, 2009. Early adoption of SFAS No. 141(R) is not permitted, accordingly the Company will be required to record and disclose any business combinations in accordance with existing GAAP until January 1, 2009. The effect of these new requirements on the Company's financial position and results of operations will depend on the volume and terms of acquisitions in 2009 and beyond, but will likely increase the amount and change the timing of recognizing expenses related to acquisition activities.

Derivative Disclosures:

In March 2008, the FASB issued SFAS No. 161, *Disclosures About Derivative Instruments and Hedging Activities - an amendment of SFAS No. 133* ("SFAS No. 161"), which requires an entity to provide greater transparency about how its derivative and hedging activities affect its financial statements. SFAS No. 161 requires enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, and (c) how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Since SFAS No. 161 affects only disclosures, it will not impact the Company's financial position or results of operation upon adoption.

3. SECURITIES

Securities Portfolio

(Dollar amounts in thousands)

	June 30, 2008				December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale								
U.S. Treasury	$ 1,029	$ 3	$ (2)	$ 1,030	$ 1,027	$ 2	$ (1)	$ 1,028
U.S. Agency	6,519	57	-	6,576	41,895	597	-	42,492
Collateralized mortgage obligations	542,680	2,815	(4,688)	540,807	534,688	2,333	(2,221)	534,800
Other mortgage-backed securities	528,385	1,440	(6,770)	523,055	417,532	5,116	(2,328)	420,320
State and municipal	939,484	3,389	(13,862)	929,011	961,638	7,728	(2,531)	966,835
Collateralized debt obligations	87,278	434	(26,741)	60,971	95,584	-	(13,954)	81,630
Other	48,403	241	(3,633)	45,011	35,295	34	(2,388)	32,941
Total	$ 2,153,778	$ 8,379	$ (55,696)	$ 2,106,461	$ 2,087,659	$ 15,810	$ (23,423)	$ 2,080,046
Securities Held-to-Maturity								
State and municipal	$ 94,580	$ 249	$ -	$ 94,829	$ 97,671	$ 260	$ -	$ 97,931
Trading Securities				$ 17,368				$ 18,352

During the first six months of 2008, the Company continued to closely monitor the fair value of the six asset-backed collateralized debt obligations that were subject to impairment charges in fourth quarter 2007 and recorded additional non-cash impairment charges on these securities of $2.3 million in first quarter 2008 and $6.0 million in second quarter 2008. The carrying value of these securities at June 30, 2008 was $1.8 million.

At June 30, 2008, gross unrealized gains in the securities available-for-sale portfolio totaled $8.4 million, and gross unrealized losses totaled $55.7 million, resulting in a net unrealized depreciation of $47.3 million. The unrealized loss on securities in an unrealized loss position for greater than 12 months totaled $26.4 million. Management does not believe any individual unrealized loss as of June 30, 2008 represented an other-than-temporary impairment. The Company has both the intent and ability to hold the securities with unrealized losses for a period of time necessary to recover the amortized cost, or to maturity.

Trading securities held by the Company represent diversified investment securities held in a grantor trust under deferred compensation arrangements in which plan participants may direct amounts earned to be invested in securities other than Company stock. Net trading gains (losses), representing appreciation (depreciation) in the portfolio, included in other noninterest income in the Consolidated Statements of Income totaled $40,000 in second quarter 2008 and $832,000 in second quarter 2007. Trading (losses) gains totaled $(1.4) million for the six months ended June 30, 2008 and $1.2 million for the six months ended June 30, 2007.

4. LOANS

Loan Portfolio

(Dollar amounts in thousands)

	June 30, 2008	December 31, 2007
Commercial and industrial	$ 1,448,723	$ 1,347,481
Agricultural	207,438	181,358
Real estate - office, retail, and industrial	1,048,547	942,065
Real estate - residential land and development	418,455	418,543
Real estate - multifamily	195,815	178,602
Real estate - other commercial real estate	1,107,122	1,111,141
Consumer	542,960	563,741
Real estate - 1-4 family	213,295	220,741
Total loans	$ 5,182,355	$ 4,963,672

Total loans reported are net of deferred loan fees of $9.5 million as of June 30, 2008 and $8.8 million as of December 31, 2007 and include overdrawn demand deposits totaling $8.6 million as of June 30, 2008 and $11.0 million as of December 31, 2007.

The Company primarily lends to small to mid-sized businesses and consumers in the market areas in which the Company operates. Within these areas, the Company diversifies its loan portfolio by loan type, industry, and borrower.

It is the Company's policy to review each prospective credit in order to determine the appropriateness and, when required, the adequacy of security or collateral to obtain prior to making a loan. In the event of borrower default, the Company seeks recovery in compliance with state lending laws and the Company's lending standards and credit monitoring procedures.

5. RESERVE FOR LOAN LOSSES AND IMPAIRED LOANS

Reserve for Loan Losses

(Dollar amounts in thousands)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Balance at beginning of period	$ 64,780	$ 62,400	$ 61,800	$ 62,370
Loans charged-off	(4,991)	(2,526)	(11,732)	(5,935)
Recoveries of loans previously charged-off	535	756	1,196	1,235
Net loans charged-off	(4,456)	(1,770)	(10,536)	(4,700)
Provision for loan losses	5,780	1,761	14,840	4,721
Balance at end of period	$ 66,104	$ 62,391	$ 66,104	$ 62,391

A portion of the Company's reserve for loan losses is allocated to loans deemed impaired. All impaired loans are included in nonperforming assets.

Impaired, Nonaccrual, and Past Due Loans

(Dollar amounts in thousands)

	June 30, 2008	December 31, 2007
Impaired loans:		
Impaired loans with valuation reserve required (1)	$ 4,257	$ 3,470
Impaired loans with no valuation reserve required	17,914	11,878
Total impaired loans	$ 22,171	$ 15,348
Nonperforming loans:		
Impaired loans on nonaccrual	$ 21,912	$ 15,068
Other nonaccrual loans (2)	3,324	3,379
Total nonaccrual loans	$ 25,236	$ 18,447
Restructured loans	259	280
Total nonperforming loans	$ 25,495	$ 18,727
Loans past due 90 days and still accruing interest	$ 37,510	$ 21,149
Valuation reserve related to impaired loans	231	1,757

(1) These impaired loans require a valuation reserve because the estimated value of the loans is less than the recorded investment in the loans.

(2) These loans are not considered for impairment since they are part of a small balance, homogeneous portfolio.

The average recorded investment in impaired loans was $17.0 million for the six months ended 2008 and $12.8 million for the six months ended June 30, 2007. Interest income recognized on impaired loans was $50,000 for the six months ended 2008 and $27,000 for the six months ended 2007. Interest income recognized on impaired loans is recorded using the cash basis of accounting. As of June 30, 2008, the Company had $598,000 of additional funds committed to be advanced in connection with impaired loans.

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6. EARNINGS PER COMMON SHARE

Basic and Diluted Earnings per Share

(Amounts in thousands, except per share data)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net income	$ 26,997	$ 29,311	$ 52,035	$ 58,340
Weighted-average common shares outstanding:				
Weighted-average common shares outstanding (basic)	48,459	49,617	48,446	49,768
Dilutive effect of stock options	60	335	82	357
Dilutive effect of non-vested restricted stock awards	57	32	54	27
Weighted-average diluted common shares outstanding	48,576	49,984	48,582	50,152
Basic earnings per share	$ 0.56	$ 0.59	$ 1.07	$ 1.17
Diluted earnings per share	0.56	0.59	1.07	1.16

7. PENSION PLAN

Net Periodic Benefit Pension Expense

(Dollar amounts in thousands)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Components of net periodic benefit cost:				
Service cost	$ 618	$ 802	$ 1,516	$ 1,968
Interest cost	488	633	1,197	1,554
Expected return on plan assets	(610)	(792)	(1,497)	(1,943)
Recognized net actuarial loss	139	181	342	444
Amortization of prior service cost	-	1	1	2
Net periodic cost	$ 635	$ 825	$ 1,559	$ 2,025

The Company previously disclosed in Note 16 to the Consolidated Financial Statements in its 2007 10-K that it expected to contribute $5.0 million to its Pension Plan in 2008. Based on current actuarial assumptions, the Company contributed $7.5 million to the Pension Plan in first quarter 2008.

8. COMMITMENTS, GUARANTEES, AND CONTINGENT LIABILITIES

Credit Extension Commitments and Guarantees

In the normal course of business, the Company enters into a variety of financial instruments with off-balance sheet risk to meet the financing needs of its customers, to reduce its exposure to fluctuations in interest rates, and to conduct lending activities. These instruments principally include commitments to extend credit, standby letters of credit, and commercial letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Statements of Condition.

Contractual or Notional Amounts of Financial Instruments

(Dollar amounts in thousands)

		June 30, 2008	December 31, 2007
Commitments to extend credit:			
	Home equity lines	$ 237,048	$ 266,582
	All other commitments	1,149,087	1,135,612
Letters of credit:			
	Standby	142,379	128,281
	Commercial	394	427
Recourse on assets securitized		10,375	13,252

Standby and commercial letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of the underlying contract with the third party and are most often issued in favor of a municipality where construction is taking place to ensure the borrower adequately completes the construction. Commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn on when the underlying transaction is consummated between the customer and the third party. This type of letter of credit is issued through a correspondent bank on behalf of a customer who is involved in an international business activity such as the importing of goods.

The maximum potential future payments guaranteed by the Company under standby letters of credit arrangements are equal to the contractual amount of the commitment. The carrying value of the Company's standby letters of credit, which is included in other liabilities in the Consolidated Statements of Condition, totaled $765,000 as of June 30, 2008 and $669,000 as of December 31, 2007. As of June 30, 2008, standby letters of credit had a remaining weighted-average term of approximately 12.2 months, with remaining actual lives ranging from less than 1 year to 7.0 years. If a commitment is funded, the Company may seek recourse through the liquidation of the underlying collateral provided including real estate, physical plant and property, marketable securities, or cash.

Pursuant to the securitization of certain 1-4 family mortgage loans in fourth quarter 2004, the Company is obligated by agreement to repurchase at recorded value any nonperforming loans, defined as loans past due greater than 90 days. The aggregate recorded value of securitized loans subject to this recourse obligation was $10.4 million as of June 30, 2008 and $13.3 million as of December 31, 2007. Per its agreement, the Company's recourse obligations will end on

November 30, 2011. The carrying value of the Company's recourse liability, which is included in other liabilities in the Consolidated Statements of Condition, totaled $148,000 as of June 30, 2008 and December 31, 2007.

Legal Proceedings

At June 30, 2008, there were certain legal proceedings pending against the Company and its subsidiaries in the ordinary course of business. The Company does not believe that liabilities, individually or in the aggregate, arising from these proceedings, if any, would have a material adverse effect on the consolidated financial condition of the Company as of June 30, 2008.

9. FAIR VALUE

The Company measures, monitors, and discloses certain of its assets and liabilities on a fair value basis. Fair value is used on a recurring basis to account for trading securities, securities available-for-sale, mortgage servicing rights, derivative assets, and derivative liabilities. In addition, fair value is used on a non-recurring basis to apply lower-of-cost-or-market accounting to foreclosed real estate; evaluate assets or liabilities for impairment, including collateral-dependent impaired loans, goodwill, and other intangibles; and for disclosure purposes. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Depending on the nature of the asset or liability, the Company uses various valuation techniques (i.e., discounted cash flow analysis) and input assumptions when estimating fair value, all of which are in accordance with SFAS No. 157.

SFAS No. 157 requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Furthermore, SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value into three broad levels based on the reliability of the input assumptions. The hierarchy gives the highest priority to level 1 measurements and the lowest priority to level 3 measurements. The three levels of the fair value hierarchy are defined as follows:

* Level 1 - Unadjusted quoted prices for identical assets and liabilities traded in active markets.

* Level 2 - Observable inputs other than level 1 prices, such as quoted prices for similar instruments; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

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

The categorization of where an asset or liability falls within the hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Valuation Methodology

The following describes the valuation methodologies used by the Company for assets and liabilities measured at fair value, including the general classification of the assets and liabilities pursuant to the valuation hierarchy.

Trading Securities

- Trading securities represent diversified investment securities held in a grantor trust under deferred compensation arrangements in which plan participants may direct amounts earned to be invested in securities other than Company common stock. Trading securities are reported at fair value, with unrealized gains and losses included in noninterest income. The fair value of trading securities is based on quoted market prices in active exchange markets and, therefore, is classified in level 1 of the valuation hierarchy.

Securities Available-for-Sale

- Substantially all available-for-sale securities are fixed income instruments that are not quoted on an exchange, but are traded in active markets. The fair value of these securities is based on quoted market prices obtained from external pricing services or dealer market participants. In obtaining such data from external pricing services, the Company has evaluated the methodologies used to develop the fair values in order to determine whether such valuations are representative of an exit price in the Company's principal markets. The Company's principal markets for its securities portfolio are the secondary institutional markets, with an exit price that is predominantly reflective of bid level pricing in those markets. Examples of such securities measured at fair value are U.S. Treasury and Agency securities, municipal bonds, collateralized mortgage obligations, and other mortgage-backed securities. These securities are generally classified in level 2 of the valuation hierarchy. In certain cases where there is limited activity or less transparency for inputs to the valuation, securities are classified in level 3 of the valuation hierarchy. For instance, in the valuation of certain collateralized mortgage and debt obligations and high-yield debt securities, the determination of fair value may require benchmarking to similar instruments or analyzing default and recovery rates. For asset-backed and trust-preferred collateralized debt obligations ("CDOs"), the Company obtained price information from third-party dealer quotes, as this level of evidence is the strongest support absent current market activity for the fair value of these securities. Due to the illiquidity in the secondary market for CDOs, especially since the disruption in the sub-prime credit markets during 2007 and 2008, these fair value estimates cannot be corroborated by observable market data. Therefore, while the majority of the Company's securities portfolio was classified in level 2, the CDO securities were classified in level 3 of the valuation hierarchy. Certain securities available-for-sale are carried at cost, including other miscellaneous marketable equity securities. The carrying value of these cost investments approximates fair value.

Collateral-Dependent Impaired Loans

- The carrying value of impaired loans is disclosed in Note 5, "Reserve for Loan Losses and Impaired Loans." The Company does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs that are based on the current appraised or market-quoted value of the underlying collateral or (2) the full charge-off of the loan carrying value. In some cases, the properties for which market quotes or appraised values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Accordingly, fair value estimates, including those obtained from real estate brokers or other third-party consultants, for collateral-dependent impaired loans are classified in level 3 of the valuation hierarchy.

Mortgage Servicing Rights

- The Company records its mortgage servicing rights at fair value in accordance with SFAS No. 156, *Accounting for Servicing of Financial Assets, an amendment of SFAS No. 140*. Mortgage servicing rights do not trade in an active market with readily observable prices. Accordingly, the Company determines the fair value of mortgage servicing rights by estimating the present value of the future cash flows associated with the mortgage loans being serviced. Key economic assumptions used in measuring the fair value of mortgage servicing rights include prepayment speeds and discount rates. While market-based data is used to determine the input assumptions, the Company incorporates its own estimates of assumptions market participants would use in determining the fair value of mortgage servicing rights and classifies them in level 3 of the valuation hierarchy.

Derivative Assets and Derivative Liabilities

- The interest rate swaps entered into by the Company are executed in the dealer market and priced based on market quotes obtained from the counterparty that transacted the derivative contract. The market quotes were developed by the counterparty using market observable inputs, which primarily include the London Interbank Offered Rate ("LIBOR") for swaps. As the fair value estimates for interest rate swaps are primarily based on LIBOR, which is a market observable input, derivatives are classified in level 2 of the valuation hierarchy. For its derivative assets and liabilities, the Company also considers nonperformance risk, including the likelihood of default by itself and its counterparties, when evaluating whether the market quotes from the counterparty are representative of an exit price. The

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Company has a policy of executing derivative transactions only with counterparties above a certain credit rating. Credit risk is also mitigated through the pledging of collateral when certain thresholds are reached. The likelihood of the Company's default is considered remote and its credit rating has remained stable over the past recent history. For these reasons, nonperformance risk is considered extremely low and accordingly, any such credit risk adjustments to the Company's derivative assets and liabilities would be immaterial.

Assets and Liabilities Measured at Fair Value

The following table provides the hierarchy level and fair value for each major category of assets and liabilities measured at fair value at June 30, 2008.

Fair Value Measurements

(Dollar amounts in thousands)

	June 30, 2008			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets and liabilities measured at fair value on a recurring basis				
Assets:				
Trading securities	$ 17,368	$ -	$ -	$ 17,368
Securities available-for-sale (1)	-	2,028,502	77,959	2,106,461
Mortgage servicing rights (2)	-	-	1,632	1,632
Total assets	$ 17,368	$ 2,028,502	$ 79,591	$ 2,125,461
Liabilities:				
Derivative liabilities (2)	$ -	$ 387	$ -	$ 387
Assets measured at fair value on a non-recurring basis				
Collateral-dependent impaired loans net of reserve for loan losses (3)	$ -	$ -	$ 7,288	$ 7,288

(1) Includes other miscellaneous marketable equity securities with an aggregate carrying value totaling $2.9 million that is assumed to approximate fair value.

(2) Mortgage servicing rights are included in other assets, and derivative liabilities are included in other liabilities in the Consolidated Statements of Financial Condition.

(3) Represents the carrying value of loans for which adjustments are based on the appraised or market-quoted value of the collateral.

In accordance with the provisions of FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, collateral-dependent impaired loans with a carrying value of $14.2 million, less transfers to foreclosed real estate of $1.4 million, were written down to their fair value of $7.3 million, resulting in a provision for loan losses of $5.5 million, which was included in earnings for the six months ended June 30, 2008.

Reconciliation of Beginning and Ending Fair Value For Those
Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

(Dollar amounts in thousands)

	Quarters Ended June 30, 2008		Six Months Ended June 30, 2008	
	Securities Available-For-Sale	Mortgage Servicing Rights	Securities Available-For-Sale	Mortgage Servicing Rights
Balance at beginning of period	$ 92,808	$ 1,799	$ 110,496	$ 1,877
Total gains (losses):				
Included in earnings [1]	(4,556)	(167)	(6,837)	(245)
Included in other comprehensive income	(8,272)	-	(12,450)	-
Purchases, sales, issuances, and settlements	(2,021)	-	(2,600)	-
Transfers out of Level 3 [2]	-	-	(10,650)	-
Balance at end of period	$ 77,959	$ 1,632	$ 77,959	$ 1,632
Change in unrealized losses in earnings relating to assets and liabilities still held at end of period	$ (5,962)	$ -	$ (8,243)	$ -

(1) Total gains and losses included in earnings for securities available-for-sale are reported in securities gains (losses), net, and gains and losses on mortgage servicing rights are reported in other service charges, commissions, and fees in the Consolidated Statements of Income.

(2) The transfer out of level 3 represents a single security that was manually priced using broker quotes (a level 3 input) at December 31, 2007, but valued by an external pricing service (a level 2 input) at June 30, 2008.

In the table above, the net losses recognized in earnings for securities available-for-sale represent additional non-cash impairment charges recognized during first and second quarter 2008 on certain asset-backed CDOs that were deemed to be other-than-temporarily impaired, net of the gain realized on the sale of an asset-backed CDO previously written down.

10. INCOME TAXES

The Company's provision for income taxes includes both federal and state income tax expense. Following is an analysis of the provision for income taxes and the effective income tax rates for the periods presented.

	Quarters Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Income before income tax expense	$ 27,024	$ 39,089	$ 57,140	$ 77,044
Income tax expense	27	9,778	5,105	18,704
Effective income tax rate	0.1%	25.0%	8.9%	24.3%
Federal effective income tax rate	9.9%	24.9%	15.7%	24.2%
State effective income tax rate, net of federal tax effect	(9.8%)	0.1%	(6.8%)	0.1%

The federal effective income tax rate and changes in that rate are greatly influenced by the amount of tax-exempt income derived from investment securities and bank owned life insurance ("BOLI"). The state effective income tax rate and changes in that rate are dependent upon Illinois, Indiana, and Iowa income tax rules relating to consolidated/combined reporting, sourcing of income and expense, and the amount of tax-exempt income derived from loans, investment securities, and BOLI. As a result of a favorable court decision and certain favorable developments in pending tax audits during the quarter, the Company increased the amount of benefit recognized with respect to identified uncertain tax positions under FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes* ("FIN 48").

The increase in recognized tax benefit resulted in a $4.9 million reduction in tax expense during the quarter and is the primary reason for the decrease in effective income tax rate from 2007 to 2008.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The discussion presented below provides an analysis of our results of operations and financial condition for the quarters ended June 30, 2008 and 2007. When we use the terms "First Midwest," the "Company," "we," "us," and "our," we mean First Midwest Bancorp, Inc., a Delaware Corporation, and its consolidated subsidiaries. When we use the term the "Bank," we are referring to our wholly-owned banking facility, First Midwest Bank. Management's discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying notes presented elsewhere in this report, as well as in our 2007 Annual Report on Form 10-K ("2007 10-K"). Results of operations for the quarter and six months ended June 30, 2008 are not necessarily indicative of results to be expected for the year ending December 31, 2008. Unless otherwise stated, all earnings per share data included in this section and throughout the remainder of this discussion are presented on a diluted basis.

PERFORMANCE OVERVIEW

General Overview

Our banking network provides a full range of business and retail banking and trust and advisory services through 98 banking offices, primarily in suburban metropolitan Chicago. The primary sources of our revenue are net interest income and fees from financial services provided to customers. Business volumes tend to be influenced by overall economic factors including market interest rates, business spending, consumer confidence, and competitive conditions within the marketplace.

Second Quarter 2008 vs. 2007

Net income for the quarter ended June 30, 2008 was $27.0 million, or $0.56 per share, compared to $29.3 million, or $0.59 per share, for second quarter 2007. Second quarter 2008 performance resulted in an annualized return on average assets of 1.33% compared to 1.44% for second quarter 2007, and an annualized return on average equity of 14.6% compared to 15.5% for second quarter 2007.

Net income for the six-month period ended June 30, 2008 was $52.0 million, or $1.07 per share, compared to $58.3 million, or $1.16 per share, for the same period of 2007. Our annualized returns on average assets and average equity for the six-month period ended June 30, 2008 were 1.29% and 14.2%, respectively, compared to 1.43% and 15.5% for the same period of 2007.

Total loan balances at June 30, 2008 increased $272.5 million from a year ago and $218.7 million from December 31, 2007, building on the momentum we generated in the last half of 2007. The growth was primarily in the commercial real estate and commercial and industrial lines.

The ratio of nonperforming assets plus loans past due 90 days as a percent of total loans plus foreclosed real estate was 1.35% at June 30, 2008 compared to 0.92% at December 31, 2007 and 0.78% at June 30, 2007. The increase is related primarily to loans to home builders and developers and reflects the impact of declining home prices on sales of new developments.

Net interest margin of 3.58% declined only 3 basis points from 3.61% for second quarter 2007 despite the Federal Reserve's 325 basis point decrease in the federal funds rate over the past year. We substantially offset the reduced loan yields with lower rates on wholesale borrowings, reduced rates paid on portions of our retail deposits, a widening of loan spreads, and expanded spreads on our investment portfolio.

Our fee-based revenues for the quarter and six-month periods ended June 30, 2008 declined 6.5% and 1.3%, respectively, from the same periods of 2007. Such declines were due primarily to the elimination of fees attendant to discontinuing both originating mortgages and the outsourcing of our cashier check balances. Our noninterest expense for the quarter and six-month periods ended June 30, 2008 decreased 1.6% and increased 0.4%, respectively, from the same periods of 2007.

We had certain other significant transactions that affected net income for the quarter and six-month periods ended June 30, 2008. We recognized net securities losses of $4.6 million in second quarter 2008, compared to net securities gains of $961,000 in second quarter 2007. For the six-month periods ended June 30, 2008 and 2007 we recognized $350,000 and $4.4 million in net securities gains, respectively. We recorded additional tax benefits during the six-month period ended June 30, 2008 of $6.8 million, including $4.9 million in second quarter 2008 related to the reversal of income tax reserves due to favorable events affecting certain tax positions.

Business Outlook

Despite the Federal Reserve's significant and, in some cases, unprecedented, actions to buttress the capital markets and calm investors' concerns, the uncertainty that manifested itself in recurring credit and liquidity problems in 2007 continued throughout the first six months of 2008. During this period, the Federal Reserve's actions significantly reduced the cost of overnight borrowing for banks, enabled JPMorgan Chase & Co. to purchase Bear Stearns Companies, Inc., and allowed investment banks to borrow directly from the Federal Reserve. In July 2008, the U.S. Congress passed legislation that provides unprecedented support to the two largest mortgage finance providers, Fannie Mae and Freddie Mac.

As we have previously noted, the Chicagoland economy reflects many aspects of the national marketplace. Employment is weakening and housing sales are down since June of 2007. Developers of residential properties, faced with excess inventory of new housing, have been especially hard hit. Until housing sales activity recovers, their cash flows will be severely diminished. Consequently, banks are seeing greater delinquencies in this portfolio, and the value of underlying collateral is under pressure in some cases. In the first and second quarters of 2008, we increased our loan loss reserve in anticipation of losses in our residential development portfolio.

We have been profitably engaged in lending to residential developers for over two decades, a period of time that encompassed two pronounced economic downturns. We firmly believe it is our long-term relationship approach to doing business with our customers that has enabled us to endure and thrive. This segment comprises 15.1% of our $2.8 billion real estate commercial and construction portfolio and is almost entirely concentrated in the Chicagoland market. We have been and will remain fully engaged with these borrowers and this marketplace. We believe the remainder of our portfolio is well positioned in this environment, with relatively small exposures to consumer loans and mortgages, no consumer credit card loans, and virtually no indirect auto lending.

We remain encouraged about our long-term prospects for profitable growth. The diverse Chicago marketplace continues to provide sales opportunities as evidenced by our double-digit loan growth in the second quarter of 2008. In addition, we believe the pricing of such loans appropriately reflects current credit risks. We have an efficient operating model with very experienced credit underwriters who have demonstrated the capacity to underwrite and collect credit while dealing with similar market dynamics in the past. Finally, we believe we have the liquidity and capital to support our loan activity while satisfying all regulatory requirements.

EARNINGS PERFORMANCE

Net Interest Income

Net interest income equals the difference between interest income plus fees earned on interest-earning assets and interest expense incurred on interest-bearing liabilities. The level of interest rates and the volume and mix of interest-earning assets and interest-bearing liabilities impact net interest income. Net interest margin represents net interest income as a percentage of total average interest-earning assets. The accounting policies underlying the recognition of interest income on loans, securities, and other interest-earning assets are included in the Notes to Consolidated Financial Statements contained in our 2007 10-K.

Our accounting and reporting policies conform to U.S. generally accepted accounting principles ("GAAP") and general practice within the banking industry. For purposes of this discussion, both net interest income and net interest margin have been adjusted to a fully tax-equivalent basis to more appropriately compare the returns on certain tax-exempt loans and securities to those on taxable interest-earning assets. Although we believe that these non-GAAP financial measures enhance investors' understanding of our business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP. The reconciliation of such adjustment is presented in the following table.

Table 1
Effect of Tax-Equivalent Adjustment

(Dollar amounts in thousands)

	Quarters Ended June 30,			Six Months Ended June 30,		
	2008	2007	% Change	2008	2007	% Change
Net interest income (GAAP)	$ 60,326	$ 60,964	(1.0)	$ 118,826	$ 121,334	(2.1)
Tax-equivalent adjustment	5,603	5,252	6.7	11,157	10,682	4.4
Tax-equivalent net interest income	$ 65,929	$ 66,216	(0.4)	$ 129,983	$ 132,016	(1.5)

Tax-equivalent net interest income for the quarter and six-month periods ended June 30, 2008 declined 0.4% and 1.5%, respectively, compared to the same periods in 2007.

Table 2 summarizes the changes in our average interest-earning assets and interest-bearing liabilities as well as the average interest rates earned and paid on these assets and liabilities, respectively, for the quarters ended June 30, 2008 and 2007. The table also details increases and decreases in income and expense for each of the major categories of interest-earning assets and interest-bearing liabilities and analyzes the extent to which such variances are attributable to volume and rate changes. Interest income and yields are presented on a tax-equivalent basis assuming a federal income tax rate of 35%, which includes the tax-equivalent adjustment as presented in Table 1 above.

Net interest margin for second quarter 2008 of 3.58% declined 3 basis points from 3.61% for second quarter 2007 despite the Federal Reserve's 325 basis point decrease in the federal funds rate over the past year. With approximately one-half of our loan portfolio tied to floating indices, the decline in the Federal Reserve's federal funds rate resulted in a decline of 158 basis points in average loan yields from second quarter 2007. This negative impact was offset by a decline in our short-term wholesale borrowing rates, a decline in the rates paid on portions of our customer deposits, a widening of loan spreads, and expanded spreads on our investment portfolio as the interest rate yield curve steepened.

As shown in Table 2, second quarter 2008 tax-equivalent interest income declined $19.0 million compared to second quarter 2007. The increase in interest-earning assets increased interest income by $2.5 million, while a decline in the average rate earned on interest-earning assets reduced interest income by $21.5 million. Second quarter 2008 interest expense declined $18.7 million compared to second quarter 2007. The increase in interest-bearing liabilities increased interest expense by $832,000, and a decrease in the average rate paid on interest-bearing liabilities reduced interest expense by $19.6 million.

As shown in Table 3, net interest margin was 3.55% for the first six months of 2008 compared to 3.57% for the first six months of 2007. Tax equivalent interest income declined $32.0 million for the first six months of 2008 compared to the first six months of 2007. The decrease in interest-earning assets decreased interest income by $1.5 million, while a decline in the average rate earned on interest-earning assets reduced interest income by $30.5 million. Interest expense for the first six months of 2008 declined $30.0 million compared to the first six months of 2007. The decrease in interest-bearing liabilities decreased interest expense by $1.5 million, and a decrease in the average rate paid on interest-bearing liabilities reduced interest expense by $28.5 million.

We continue to use multiple interest rate scenarios to rigorously assess the direction and magnitude of changes in interest rates and their impact on net interest income. A description and analysis of our market risk and interest rate sensitivity profile and management policies is included in Item 3, "Quantitative and Qualitative Disclosures About Market Risk," of this Form 10-Q.

Table 2
Net Interest Income and Margin Analysis

(Dollar amounts in thousands)

Quarters Ended June 30, 2008 and 2007				
	Average Balances	Average Interest Rates Earned/Paid	Interest Income/Expense	Increase/(Decrease) in Interest Income/Expense Due to:

	2008	2007	Increase (Decrease)	2008	2007	Basis Points Inc/(Dec)	2008	2007	Increase (Decrease)	Volume	Rate	Total
Federal funds sold and other short-term investments	$ 19,964	$ 10,412	$ 9,552	2.08%	5.59%	(351)	$ 103	$ 145	(42)	$ (133)	$ 91	$ (42)
Mortgages held for sale	-	6,400	(6,400)	-	5.26%	(526)	-	84	(84)	(84)	-	(84)
Trading account securities	17,363	16,778	585	1.24%	1.50%	(26)	54	63	(9)	2	(11)	(9)
Securities available-for-sale	2,105,626	2,213,530	(107,904)	5.63%	5.54%	9	29,629	30,679	(1,050)	(1,528)	478	(1,050)
Securities held-to-maturity	98,383	107,513	(9,130)	6.73%	6.77%	(4)	1,656	1,820	(164)	(154)	(10)	(164)
Federal Home Loan Bank and Federal Reserve Bank stock	54,767	54,767	-	2.42%	3.97%	(155)	332	544	(212)	-	(212)	(212)
Loans:												
Commercial and industrial	1,423,479	1,393,984	29,495	5.96%	7.77%	(181)	21,103	26,994	(5,891)	584	(6,475)	(5,891)
Agricultural	205,867	162,573	43,294	4.97%	7.25%	(228)	2,546	2,938	(392)	2,114	(2,506)	(392)
Real estate - commercial	2,705,016	2,576,166	128,850	6.00%	7.47%	(147)	40,370	47,971	(7,601)	2,607	(10,208)	(7,601)
Consumer	544,655	603,227	(58,572)	5.73%	7.62%	(189)	7,761	11,467	(3,706)	(1,035)	(2,671)	(3,706)
Real estate - 1-4 family	218,569	208,533	10,036	6.19%	6.19%	-	3,362	3,218	144	154	(10)	144
Total loans	5,097,586	4,944,483	153,103	5.93%	7.51%	(158)	75,142	92,588	(17,446)	4,424	(21,870)	(17,446)

Total interest-earning assets	$ 7,393,689	$ 7,353,883	$ 39,806	5.81%	6.86%	(105)	$ 106,916	$ 125,923	(19,007)	$ 2,527	(21,534)	(19,007)
Savings deposits	$ 823,196	$ 746,702	$ 76,494	0.86%	1.48%	(62)	$ 1,755	$ 2,763	$ (1,008)	$ 321	(1,329)	(1,008)
NOW accounts	953,808	905,683	48,125	1.04%	1.55%	(51)	2,465	3,509	(1,044)	198	(1,242)	(1,044)
Money market deposits	818,815	858,639	(39,824)	1.60%	3.41%	(181)	3,256	7,307	(4,051)	(325)	(3,726)	(4,051)
Time deposits	2,161,611	2,336,009	(174,398)	3.83%	4.81%	(98)	20,560	28,014	(7,454)	(1,976)	(5,478)	(7,454)
Borrowed funds	1,331,195	1,162,315	168,880	2.79%	4.96%	(217)	9,249	14,363	(5,114)	2,541	(7,655)	(5,114)
Subordinated debt	232,492	228,229	4,263	6.40%	6.59%	(19)	3,702	3,751	(49)	73	(122)	(49)
Total interest-bearing liabilities	$ 6,321,117	$ 6,237,577	$ 83,540	2.61%	3.84%	(123)	$ 40,987	$ 59,707	(18,720)	$ 832	(19,552)	(18,720)
Net interest margin / income				3.58%	3.61%	(3)	$ 65,929	$ 66,216	$ (287)	$ 1,695	$ (1,982)	$ (287)

	2008		2007			
Net Interest Margin Trend By Quarter	2nd	1st	4th	3rd	2nd	1st
Yield on interest-earning assets	5.81%	6.29%	6.67%	6.91%	6.86%	6.83%
Rates paid on interest-bearing liabilities	2.61%	3.23%	3.71%	3.86%	3.84%	3.88%
Net interest margin	3.58%	3.53%	3.53%	3.63%	3.61%	3.53%

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Table 3
Net Interest Income and Margin Analysis

(Dollar amounts in thousands)

Six Months Ended June 30, 2008 and 2007			
Average Balances	Average Interest Rates Earned/Paid	Interest Income/Expense	Increase/(Decrease) in Interest Income/Expense Due

												to:
	2008	2007	Increase (Decrease)	2008	2007	Basis Points Inc/(Dec)	2008	2007	Increase (Decrease)	Volume	Rate	Total
Federal funds sold and other short-term investments	$ 10,943	$ 11,531	$ (588)	2.22%	5.42%	(320)	$ 121	$ 310	$ (189)	$ (15)	$ (174)	$ (189)
Mortgages held for sale	74	4,676	(4,602)	8.15%	5.56%	259	3	129	(126)	(242)	116	(126)
Trading account securities	17,984	16,464	1,520	1.29%	1.53%	(24)	116	126	(10)	14	(24)	(10)
Securities available-for-sale	2,097,381	2,264,211	(166,830)	5.72%	5.55%	17	59,988	62,864	(2,876)	(4,869)	1,993	(2,876)
Securities held-to-maturity	97,065	101,311	(4,246)	6.71%	6.80%	(9)	3,257	3,445	(188)	(142)	(46)	(188)
Federal Home Loan Bank and Federal Reserve Bank stock	54,767	54,782	(15)	2.45%	4.28%	(183)	670	1,171	(501)	-	(501)	(501)
Loans net of unearned discount:												
Commercial and industrial	1,390,175	1,392,382	(2,207)	6.27%	7.69%	(142)	43,352	53,094	(9,742)	(84)	(9,658)	(9,742)
Agricultural	192,977	169,326	23,651	5.30%	7.19%	(189)	5,090	6,034	(944)	1,098	(2,042)	(944)
Real estate - commercial	2,701,737	2,587,808	113,929	6.29%	7.48%	(119)	84,481	95,970	(11,489)	4,732	(16,221)	(11,489)
Consumer	550,453	618,522	(68,069)	6.19%	7.60%	(141)	16,950	23,301	(6,351)	(2,388)	(3,963)	(6,351)
Real estate	222,835	210,995	11,840	6.24%	6.21%	3	6,917	6,498	419	368	51	419

- 1-4 family												
Total loans	5,058,177	4,979,033	79,144	6.23%	7.49%	(126)	156,790	184,897	(28,107)	3,726	(31,833)	(28,107)
Total interest-earning assets	$ 7,336,391	$ 7,432,008	$ (95,617)	6.05%	6.85%	(80)	$ 220,945	$ 252,942	$ (31,997)	$ (1,528)	$ (30,469)	$ (31,997)
Savings deposits	$ 818,980	$ 726,236	$ 92,744	1.09%	1.36%	(27)	$ 4,426	$ 4,910	$ (484)	$ 848	$ (1,332)	$ (484)
NOW accounts	917,157	887,972	29,185	1.16%	1.50%	(34)	5,277	6,613	(1,336)	225	(1,561)	(1,336)
Money market deposits	820,484	860,535	(40,051)	1.91%	3.39%	(148)	7,788	14,484	(6,696)	(646)	(6,050)	(6,696)
Time deposits	2,168,396	2,416,777	(248,381)	4.15%	4.82%	(67)	44,755	57,713	(12,958)	(5,585)	(7,373)	(12,958)
Borrowed funds	1,319,296	1,194,875	124,421	3.25%	5.01%	(176)	21,325	29,712	(8,387)	3,553	(11,940)	(8,387)
Subordinated debt	231,475	228,447	3,028	6.42%	6.62%	(20)	7,391	7,494	(103)	101	(204)	(103)
Total interest-bearing liabilities	$ 6,275,788	$ 6,314,842	$ (39,054)	2.91%	3.86%	(95)	$ 90,962	$ 120,926	$ (29,964)	$ (1,504)	$ (28,460)	$ (29,964)
Net interest margin / income				3.55%	3.57%	(2)	$ 129,983	$ 132,016	$ (2,033)	$ (24)	$ (2,009)	$ (2,033)

Noninterest Income

Table 4

Noninterest Income Analysis

(Dollar amounts in thousands)

	Quarters Ended June 30,		%	Six Months Ended June 30,		%
	2008	2007	Change	2008	2007	Change
Service charges on deposit accounts	$ 11,385	$ 11,483	(0.9)	$ 21,807	$ 21,070	3.5
Trust and investment advisory fees	3,945	3,916	0.7	7,892	7,706	2.4
Other service charges, commissions, and fees	4,456	6,099	(26.9)	9,458	11,258	(16.0)
Card-based fees	4,236	4,181	1.3	8,134	7,892	3.1
Subtotal fee-based revenues	24,022	25,679	(6.5)	47,291	47,926	(1.3)
Bank owned life insurance	2,145	1,982	8.2	4,607	3,893	18.3
Trading gains (losses), net	40	832	(95.2)	(1,380)	1,156	(219.4)
Other income	834	1,169	(28.7)	1,574	1,943	(19.0)
Subtotal	27,041	29,662	(8.8)	52,092	54,918	(5.1)
Securities (losses) gains, net	(4,618)	961	(580.5)	350	4,405	(92.1)
Total noninterest income	$ 22,423	$ 30,623	(26.8)	$ 52,442	$ 59,323	(11.6)

Our total noninterest income for second quarter 2008 decreased by $8.2 million, or 26.8%, compared to second quarter 2007. Fee-based revenues for second quarter 2008 were $24.0 million, a decrease of 6.5% from second quarter 2007. In fourth quarter 2007 we ceased originating traditional residential mortgages, and in first quarter 2008, we began to maintain cashier check balances in-house rather than outsource the service. If revenues from mortgage sales and formerly outsourced cashier check balances are excluded from second quarter 2007, fee-based revenues decreased 2.7%.

Service charges on deposit accounts decreased 0.9% in second quarter 2008 compared to second quarter 2007 as a result of a $504,000 decrease in fees received on items drawn on customer accounts with insufficient funds substantially offset by a $476,000 increase in service charges on business checking accounts. Trust and investment advisory fees increased 0.7% due in part to a $245.0 million increase in average assets under management. Other service charges, commissions, and fees declined 26.9% for second quarter 2008 compared to second quarter 2007 due to the ceasing of originating traditional residential mortgages and formerly outsourced cashier check balances as well as a decline in commissions received from the sale of third-party annuity and investment products. Card-based fees for second quarter 2008 increased 1.3% from second quarter 2007, with most of the increase related to higher usage. Other income declined 28.7% for second quarter 2008 compared to second quarter 2007 as second quarter 2007 included a reduction in an accrual for credit card conversion costs and a favorable lawsuit settlement.

For the six months ended June 30, 2008, noninterest income was down 11.6% compared to the same period in 2007. Fee-based revenues for the first six months of 2008 were $47.3 million, a decrease of 1.3% from the first six months of 2007. If revenues from mortgage sales and outsourced cashier check balances are excluded from the 2007 period, fee-based revenues increased 2.5%.

Bank owned life insurance ("BOLI") represents benefit payments received and the change in cash surrender value ("CSV") of the policies, net of premiums paid. In first quarter 2008, we received $305,000 of benefit payments. The increase in the CSV was attributable to earnings credited to policies, based on investments made by the insurer. The tax-equivalent yield on BOLI was 7.1% for second quarter 2008, compared to 6.7% for second quarter 2007. See page

*30 for a discussion of our investment in bank owned life insurance.

Trading gains (losses), net represent the change during the quarter in the fair value of trading securities held on behalf of participants in our non-qualified deferred compensation plan. Such change is substantially offset by an adjustment to salaries and benefits expense.

We recognized a net securities loss in second quarter 2008 of $4.6 million and a net securities gain of $350,000 for the first half of 2008. The second quarter 2008 net loss was comprised of a $6.0 million writedown of certain asset-backed collateralized debt obligations, offset by a $1.4 million gain on the sale of one of these securities previously written down.

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For further discussion on net securities gains and impairment charges, see the section titled "Investment Portfolio Management."

Noninterest Expense

Noninterest expense decreased $792,000, or 1.6%, for second quarter 2008 compared to second quarter 2007 and increased $396,000, or 0.4%, for the first six months of 2008 compared to the first six months of 2007.

Table 5
Noninterest Expense Analysis
(

Dollar amounts in thousands)

	Quarters Ended June 30,			Six Months Ended June 30,		
	2008	2007	% Change	2008	2007	% Change
Compensation expense:						
Salaries and wages	$ 20,143	$ 22,656	(11.1)	$ 39,167	$ 43,459	(9.9)
Retirement and other employee benefits	6,225	6,352	(2.0)	13,391	13,099	2.2
Total compensation expense	26,368	29,008	(9.1)	52,558	56,558	(7.1)
Net occupancy expense	5,528	5,386	2.6	11,679	10,888	7.3
Equipment expense	2,451	2,590	(5.4)	5,018	5,216	(3.8)
Technology and related costs	1,820	1,849	(1.6)	3,591	3,557	1.0
Professional services	2,611	2,219	17.7	4,905	4,321	13.5
Advertising and promotions	1,713	1,541	11.2	2,750	2,553	7.7
Merchant card expense	1,780	1,728	3.0	3,426	3,278	4.5
Other expenses	7,674	6,416	19.6	15,361	12,521	22.7
Total noninterest expense	$ 49,945	$ 50,737	(1.6)	$ 99,288	$ 98,892	0.4
Efficiency ratio	51.7%	52.1%		52.8	52.2%	

Salaries and wages decreased $2.5 million, or 11.1%, in second quarter 2008 compared to second quarter 2007 as annual general merit increases were more than offset by targeted staff reductions, a reduction in the obligation due to participants under deferred compensation plans, and a reduction in stock-based compensation expenses. The 17.7% increase in professional services was driven by increased legal and other costs in connection with nonperforming loans as well as increases in general legal expenses. Other expenses increased $1.3 million and $2.8 million for the quarter and six-month periods ended June 30, 2008, respectively, compared to the same periods in 2007 and were due primarily to additional expenses associated with properties classified as other real estate owned ("OREO").

The efficiency ratio expresses noninterest expense as a percentage of tax-equivalent net interest income plus total fees and other income.

Income Taxes

Our accounting policies underlying the recognition of income taxes in the Consolidated Statements of Condition and Income are included in Notes 1 and 16 to the Consolidated Financial Statements of our 2007 10-K.

Income tax expense totaled $27,000 for second quarter 2008 compared to $9.8 million for second quarter 2007, resulting in an effective income tax rate of 0.1% for second quarter 2008 compared to 25.0% for second quarter 2007. The decline from the prior year is due primarily to the recognition of $4.9 million in income tax benefits relating principally to certain favorable second quarter 2008 developments affecting the Company's uncertain tax positions under FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes* ("FIN 48").

The effective income tax rate was 8.9% for the first six months of 2008 compared to 24.3% for the same period in 2007. The decrease was the result of the application of FIN 48 as well as an additional state tax benefit of $1.9 million in first quarter 2008 associated with the fourth quarter 2007 securities impairment charge.

The State of Illinois has enacted legislation that significantly changes the income sourcing rules relating to financial organizations. To date, the State has not issued regulations or other clarifying guidance. We have considered, to the extent possible, the impact of the legislation, and are currently evaluating opportunities under the new rules. Based on our assessment to date, the legislation is not expected to have a material impact on our 2008 state tax expense, but could result in a low single digit increase in our effective tax rate beginning in 2009. Actual results will depend on the impact of final regulation on the opportunities being evaluated by management.

FINANCIAL CONDITION

Investment Portfolio Management

We manage our investment portfolio to maximize the return on invested funds within acceptable risk guidelines, to meet pledging and liquidity requirements, and to adjust balance sheet interest rate sensitivity to insulate net interest income against the impact of changes in interest rates.

We adjust the size and composition of our securities portfolio according to a number of factors, including expected loan growth, anticipated changes in collateralized public funds on account, the interest rate environment, and the related value of various segments of the securities markets. The following provides a valuation summary of our investment portfolio.

Table 6
Investment Portfolio Valuation Summary

(Dollar amounts in thousands)

	At June 30, 2008			At December 31, 2007		
	Fair Value	Amortized Cost	% of Total	Fair Value	Amortized Cost	% of Total
Available-for-Sale						
U.S. Treasury securities	$ 1,030	$ 1,029	-	$ 1,028	$ 1,027	-
U.S. Agency securities	6,576	6,519	0.3	42,492	41,895	1.9
Collateralized mortgage obligations	540,807	542,680	24.1	534,800	534,688	24.5
Other mortgage-backed securities	523,055	528,385	23.5	420,320	417,532	19.1
State and municipal securities	929,011	939,484	41.8	966,835	961,638	44.0
Collateralized debt obligations	60,971	87,278	3.9	81,630	95,584	4.4
Other securities	45,011	48,403	2.2	32,941	35,295	1.6
Total available-for-sale	2,106,461	2,153,778	95.8	2,080,046	2,087,659	95.5
Held-to-Maturity						
State and municipal securities	94,829	94,580	4.2	97,931	97,671	4.5
Total securities	$ 2,201,290	$ 2,248,358	100.0	$ 2,177,977	$ 2,185,330	100.0

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At June 30, 2008			At December 31, 2007		
Effective Duration (1)	Average Life (2)	Yield to Maturity	Effective Duration (1)	Average Life (2)	Yield to Maturity