

FIRST MID ILLINOIS BANCSHARES INC
Form 10-K
March 09, 2007

**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, 2006

or

**[] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission file number: 0-13368

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

Delaware
(State or other jurisdiction of incorporation or
organization)

37-1103704
(I.R.S. Employer Identification No.)

1515 Charleston Avenue, Mattoon, Illinois
(Address of Principal Executive Offices)

61938
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:
NONE

Securities registered pursuant to Section 12(g) of the Act:
**Common stock, par value \$4.00 per share,
and related Common Stock Purchase Rights**
(Title of class)

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 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 amendment to this Form 10-K. []

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [] Accelerated filer [X] Non-accelerated filer []

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 \$119,153,000. 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 7, 2007, 4,274,481 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 2007 Annual
Meeting of Shareholders to be held on May 23, 2007 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 subsidiary, First Mid-Illinois Bank & Trust, N.A. (“First Mid 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, The Checkley Agency, Inc. (“Checkley”). The Company also wholly owns two statutory business trusts, First Mid-Illinois Statutory Trust I (“Trust I”), and First Mid-Illinois Statutory Trust II (“Trust II”), both 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. The Company acquired all of the outstanding stock of a number of community banks on the following dates:

- Mattoon Bank, Mattoon (“Mattoon Bank”) on April 2, 1984
- State Bank of Sullivan (“Sullivan Bank”) on April 1, 1985
- Cumberland County National Bank in Neoga (“Cumberland County”) on December 31, 1985
- First National Bank and Trust Company of Douglas County (“Douglas County”) on December 31, 1986
- Charleston Community Bank (“Charleston Bank”) on December 30, 1987

In April 1989, a purchase and assumption agreement was executed between First National and Mattoon Bank whereby First National purchased substantially all of the assets and assumed all of the liabilities of Mattoon Bank. On May 31, 1992, the Company merged Sullivan Bank, Cumberland County, Douglas County and Charleston Bank into First National. First National changed its name at that time to First Mid-Illinois Bank & Trust, N.A.

On July 1, 1992, the Company acquired and re-capitalized Heartland Federal Savings and Loan Association (“Heartland”), a \$125 million thrift headquartered in Mattoon with offices in Charleston, Sullivan and Urbana, Illinois. In November 1997, Heartland merged with and into First Mid Bank with First Mid Bank being the surviving entity.

On October 4, 1994, First Mid Bank acquired all of the outstanding stock of Downstate Bancshares, Inc. (“DBI”), which owned all of the stock of Downstate National Bank (“DNB”). DNB operated branch locations in Altamont and Effingham, Illinois. Immediately following the acquisition, DBI was dissolved and DNB was merged with and into First Mid Bank with First Mid Bank being the surviving entity.

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 has also opened a *de novo* branch in Decatur, Illinois and a banking center in the Student Union of Eastern Illinois University in Charleston, Illinois (2000); *de novo* branches in Champaign, Illinois and Maryville, Illinois (2002), and a *de novo* branch in Highland, Illinois (2005).

On April 20, 2001, First Mid Bank acquired all of the outstanding stock of American Bank of Illinois in Highland (“American Bank”) and merged American Bank with and into First Mid Bank with First Mid Bank being the surviving entity.

On January 29, 2002, the Company acquired all of the outstanding stock of Checkley, an insurance agency located in Mattoon.

On May 1, 2006, the Company acquired Mansfield Bancorp, Inc. (“Mansfield”), and its wholly owned subsidiary, Peoples State Bank of Mansfield (“Peoples”) with locations in Mansfield, Mahomet and Weldon, Illinois. On September 8, 2006, Peoples merged with and into First Mid Bank with First Mid Bank being the surviving entity. This cash acquisition added approximately \$108 million to total deposits, \$55.8 million to loans, \$1.5 million to premises and equipment and \$11.5 million to goodwill and core deposit intangible assets.

Employees

The Company, MIDS, Checkley and First Mid Bank, collectively, employed 347 people on a full-time equivalent basis as of December 31, 2006. 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 both 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 and wealth management through First Mid Bank and insurance brokerage through Checkley. Of these, the community banking line contributes in excess of 89% of the Company’s total revenues and profits. 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 a full range of commercial lines insurance to businesses as well as homeowner, automobile 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

Strategy for Growth

The Company believes that growth of its revenue stream and of its customer base is vital to the goal of increasing the value of its shareholders’ investment. Management attempts to grow in three primary ways:

- by organic growth through adding new customers and selling more products and services to existing customers;
- by acquisitions; and
- by entering new markets with de novo branches.

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 are trained to engage in needs-based selling whereby they make an attempt to match its products and services with the particular financial needs of individual customers and prospective customers. All senior officers of the organization are required to attend monthly sales 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 between the business lines.

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 \$176 million at December 31, 2002 to \$310 million at December 31, 2006. Approximately 69% of the Company’s total revenues are derived from lending activities. The Company has also focused on growing the 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, investment and farm management services for individuals and employee benefit services for businesses. The insurance brokerage line has focused on increasing property and casualty insurance for businesses and personal lines insurance to individuals.

Growth through a series of small 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 adding to shareholder value. As the stock of the Company has not had widespread marketability to outside investors, most past acquisitions have been cash-based transactions. While the Company expects to continue this trend in the future, it would consider a stock-based acquisition if the strategic and financial metrics were compelling. The emphasis on smaller acquisitions is due to the inherent risks accompanying acquisitions and the previously mentioned preference for cash financing rather than use of the Company’s common stock.

The Company supplements its organic growth and growth through acquisitions with de novo branches in new market areas where there is a potential for economic progress or there is a distinct competitive advantage. The Company expects to continue this approach in the future.

This overall growth strategy is designed to grow the customer base without significantly increasing the shareholder base. This requires a certain amount of financial leverage and the Company monitors its capital base carefully to satisfy all regulatory requirements while maintaining flexibility. The Company has maintained a Dividend Reinvestment Plan as well as various forms of equity compensation for directors and key managers. It has also maintained an ongoing share buy back program both as a service to shareholders and a means of maintaining optimal levels of capital. The Company uses various forms of long-term debt to augment its capital when appropriate.

Strategy for Operations and Risk Management

Operationally, the Company centralizes as many administrative and clerical tasks as possible within its home office location 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 is practicable and better manages the various forms of risk inherent in this business. This approach also allows for the best possible use of technology in day-to-day banking activities thereby reducing the potential for human error. While the Company does not employ every new technology that is introduced, it does attempt to be near the leading edge with respect to operational technology.

The Company has a comprehensive set of operational policies and procedures that have been developed over time to address risk. These policies are intended to be as close as possible to “best practices” of the financial services industry and are subjected to continual review by management and the Board of Directors. The Company’s internal audit function incorporates procedures to determine compliance with these policies.

In the business of banking, credit risk is the single most important risk as losses from uncollectible loans can significantly diminish capital, earnings and shareholder value. In order to address this risk, the lending function of First Mid Bank receives significant attention 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 of First Mid Bank. The Company has invested, and will continue to invest, significant resources to ensure the quality, experience and training of First Mid Bank’s 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. All 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 \$1.5 million. The Board of Directors must approve all underwriting decisions in excess of \$2 million.

While the underlying nature of lending will result in some amount of loan losses, First Mid Bank's loan loss experience has been good with average net charge offs amounting to \$749,000 (.12% of average loans) over the past five years. Nonperforming loans were \$3,668,000 (.51% of total loans) at December 31, 2006. Both of these percentages compare well with peer financial institutions.

Interest rate and liquidity risk are two other forms of risk embedded in the business of financial intermediation. The Company's Asset Liability Management Committee, consisting of experienced individuals 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, employing a variety of "what if" scenarios to properly plan its activities. 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 2006, the Company's net interest margin declined to 3.51% from 3.70% in 2005. This was the result of intense competition for loans and deposits as well as a flat to inverted yield curve. An inverted yield curve generally compresses a bank's margin as short term rates typically have the most impact on funding costs whereas longer-term rates have the greatest impact on loan pricing. As this interest rate environment is expected to continue into 2007, it is likely that our net interest margin will continue to experience some compression.

Markets and Competition

The Company actively competes in all areas in which First Mid Bank presently does business. First Mid Bank competes 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, and pricing of services, including interest rates paid on deposits, interest rates charged on loans, and fees charged for fiduciary and other banking services.

First Mid Bank operates facilities in the Illinois counties of Bond, Champaign, Christian, Coles, Cumberland, Dewitt, Douglas, Effingham, Macon, Madison, Moultrie, and Piatt. Each facility primarily serves the community in which it is located. First Mid Bank serves twenty different communities with twenty-eight separate locations in the towns of Altamont, Arcola, Champaign, Charleston, Decatur, DeLand, Effingham, Highland, Mansfield, Mahomet, Maryville, Mattoon, Monticello, Neoga, Pocahontas, Sullivan, Taylorville, Tuscola, Urbana, and Weldon Illinois. Within the areas of service, there are numerous competing financial institutions and financial services companies.

Website

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

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 effect on the business, operations and prospects of the Company and First Mid 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 funds 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 changes 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 establishes 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 repeals the anti-affiliation provisions of the Glass-Steagall Act and revises 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 amends the definitions of “broker” and “dealer” under the Securities Exchange Act of 1934 to remove the blanket exemption for banks. Banks now 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 registered broker-dealer affiliate. By several orders, the SEC extended the blanket exemption for banks from the definition of “broker” and “dealer” while it has considered amendments to the interim final rules. In 2003, the SEC adopted amendments to its rules relating to the “dealer” exemption for banks, and banks have been required to comply with those rules since September 30, 2003. In December 2006, the SEC proposed Regulation R to implement the new exemption from broker registration, acting jointly with the Federal Reserve Board as required by the Financial Services Regulatory Relief Act of 2006. The SEC also extended the blanket exemption for bank broker activities until July 2, 2007. The GLB Act also amends the Investment Advisers Act of 1940 to require the registration of banks that act as investment advisers for mutual funds.

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.

The Company

General. As a registered bank 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: a risk-based requirement expressed as a percentage of total risk-weighted assets, and a leverage requirement expressed as a percentage of total assets. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. The leverage requirement consists of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly rated companies, with minimum requirements of at least 4% for all others. 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.

In December 2006, the U.S. bank regulatory agencies issued a notice of proposed rule-making with respect to proposed changes in the methods by which "risk-based" assets are calculated, with the stated goal of allowing banks and bank holding companies to elect a methodology that reflects more gradations of risk. The notice indicates that the leverage ratio, which is not risk-based, would not change.

As of December 31, 2006, 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 10.91%, a Tier 1 risk-based ratio of 10.10% and a leverage ratio of 7.56%.

First Mid Bank

General. First Mid Bank is a national bank, chartered under the National Bank Act. The FDIC insures the deposit accounts of First Mid Bank. As a national bank, First Mid Bank is a member of the Federal Reserve System and is subject to the examination, supervision, reporting and enforcement requirements of the OCC, as the primary federal regulator of national banks, and the FDIC, as administrator of the deposit insurance fund.

Deposit Insurance. As an FDIC-insured institution, First Mid Bank is required to pay deposit insurance premium assessments to the FDIC. During the year ended December 31, 2006, FDIC assessments ranged from 0% of deposits to 0.27% of deposits. Under the FDIC's risk-based insurance assessment system, as amended by the Federal Deposit Insurance Reform Act and implementing regulations effective for 2007, each insured bank is required to pay deposit insurance premium assessments to the FDIC. Each insured bank is placed in one of four risk categories based on its level of capital, supervisory ratings and other risk measures, including debt ratings for large institutions, and its insurance assessment rate is determined by its risk category. There is currently a 38 basis point spread between the highest and lowest assessment rates, so that banks classified by the FDIC in Risk Category I are subject in 2007 to an insurance assessment of five to seven basis points (according to the FDIC's assessment of the bank's strength), and banks classified by the FDIC in Risk Category IV are subject to an insurance assessment rate of .43%. Banks which paid assessments prior to December 31, 1996 are eligible for certain on-time credits against these assessments from a pool provided for in the legislation.

The FDIC may terminate the deposit insurance of any insured depository institution if the FDIC determines, after a hearing, that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, order, or any condition imposed in writing by, or written agreement with, the FDIC. The FDIC may also suspend deposit insurance temporarily during the hearing process for a permanent termination of insurance if the institution has no tangible capital. Management of the Company is not aware of any activity or condition that could result in termination of the deposit insurance of First Mid Bank.

In addition to its insurance assessment, each insured bank is subject, in 2007, to quarterly debt service assessments in connection with bonds issued by a government corporation that financed the federal savings and loan bailout. The first quarter 2007 debt service assessment was .0122%.

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, 2006, First Mid Bank paid supervisory fees to the OCC totaling \$195,000.

Capital Requirements. The OCC has established the following minimum capital standards for national banks, such as First Mid Bank: a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with minimum requirements of at least 4% for all others, and a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. 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 December 2006 notice of proposed rule-making described earlier would also apply to the manner in which risk-based assets are calculated for the Bank.

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 regulations of the OCC 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, 2006, First Mid Bank was not required by the OCC to increase its capital to an amount in excess of the minimum regulatory 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 11.83%, a Tier 1 risk-based ratio of 11.01% and a leverage ratio of 8.21%.

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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 ultimately, appointing a receiver for the institution.

Dividends. The National Bank Act imposes limitations on the amount of dividends that may be paid by a national bank, such as First Mid Bank. Generally, a national 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 exceeded its minimum capital requirements under applicable guidelines as of December 31, 2006. As of December 31, 2006, approximately \$3.7 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 may prohibit the payment of any dividends by First Mid Bank if the OCC determines that such payment would constitute an unsafe or unsound practice.

Affiliate and Insider Transactions. First Mid Bank is subject to certain restrictions under federal law, including Regulation W, 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 to its 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 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 percent of the bank's capital and surplus and, with all affiliates together, to an aggregate of 20 percent 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 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.

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 Exchange Act, 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 Riegle-Neal Act enacted in 1994 permits an adequately capitalized and adequately managed bank holding company, with Federal Reserve Board approval, to acquire banking institutions located in states other than the bank holding company's home state without regard to whether the transaction is prohibited under state law. In addition, national banks and state banks with different home states are permitted to merge across state lines, with the approval of the appropriate federal banking agency, unless the home state of a participating banking institution has passed legislation prior to that date that expressly prohibits interstate mergers. De novo interstate branching is permitted if the laws of the host state so authorize. Moreover, national banks, such as First Mid Bank, may provide trust services in any state to the same extent as a trust company chartered by that state.

Community Reinvestment Act. First Mid 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 received a satisfactory CRA rating from its regulator in its more recent CRA examination.

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 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.

Consumer Laws and Regulations. In addition to the laws and regulations discussed above, First Mid Bank is 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 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 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 Company

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 |
|---------------------------|---------------------------------------------------------------------------|
| William S. Rowland (59) | Chairman of the Board of Directors, President and Chief Executive Officer |
| Michael L. Taylor (38) | Vice President and Chief Financial Officer |
| John W. Hedges (58) | President, First Mid Bank |
| Laurel G. Allenbaugh (46) | Vice President |
| Christie L. Wright (50) | Vice President, Secretary/Treasurer |
| Stanley E. Gilliland (61) | Vice President |
| Kelly A. Downs (39) | Vice President |

William S. Rowland, age 59, has been Chairman of the Board of Directors, President and Chief Executive Officer of the Company since May 1999. He served as Executive Vice President of the Company from 1997 to 1999 and as Treasurer and Chief Financial Officer from 1989 to 1999. He also serves as Chairman of the Board of Directors and Chief Executive Officer of First Mid Bank.

Michael L. Taylor, age 38, has been the Vice President and Chief Financial Officer of the Company since May 2000. He was with AMCORE Bank in Rockford, Illinois from 1996 to 2000.

John W. Hedges, age 58, has been the President of First Mid Bank since September 1999. He was with National City Bank in Decatur, Illinois from 1976 to 1999.

Laurel G. Allenbaugh, age 46, has been Vice President of Operations since February 2000. She served as Controller of the Company and First Mid Bank from 1990 to February 2000 and has been President of MIDS since 1998.

Christie L. Wright, age 50, has been Vice President of Investments since 1995 and Secretary and Treasurer since 1998.

Stanley E. Gilliland, age 61, has been Vice President of Lending of the Company since 1985, and has been Executive Vice President of Lending for First Mid Bank since 1990.

Kelly A. Downs, age 39, has been Vice President of Human Resources since 2001, and has been with the Company since 1991.

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.

Interest rate risk. Interest rate risk is the risk that changes in market rates and prices will 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.

Liquidity risk. Liquidity risk is the risk that the Company will have insufficient 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. Liquidity risk arises whenever the maturities of financial instruments included in assets and liabilities differ.

Credit risk. Credit risk is the risk that loan customers or other counter-parties will be unable to perform their contractual obligations resulting in a negative impact on the Company's earnings. Overall economic conditions affecting businesses and consumers could impact the Company's credit losses. In addition, real estate valuations could also impact the Company's credit losses as the Company maintains \$511 million 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, 2006. 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 impact the Company's credit losses.

Operational risk. Operational risk is the risk of loss resulting from human error, inadequate or failed internal processes and systems, and external events. 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 our reputation or forgone opportunities. Any of these could potentially have a material adverse effect on our financial condition and results of operations.

Risk of changes in economic or market conditions. The Company's financial condition and results of operations are sensitive to the general business and economic conditions in the United States and in its area of operations in central Illinois. These conditions include short-term and long-term interest rates, inflation, fluctuations in debt and equity capital markets, agricultural prices for land and crops, commercial and residential real estate values, and the strength of the U.S. economy, as well as the local economies in which it conducts business. An economic downturn within the Company's footprint could negatively impact household and corporate incomes. This impact may lead to decreased demand for loan and deposit products and increase the number of customers who fail to pay interest or principal on their loans. This could have a negative effect on the Company's financial condition and results of operations. Changes in economic conditions are generally beyond the Company's control and difficult to predict.

General business risks. The Company is also 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.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

The Company or First Mid Bank own all of the following properties except those specifically identified as being leased.

First Mid Bank

Mattoon. First Mid Bank's main office is located at 1515 Charleston Avenue, Mattoon, Illinois. The office building consists of a one-story structure with occupied basement, which was opened in 1965 with approximately 36,000 square feet of office space, four walk-up teller stations, and four sit-down teller stations. Adjacent to this building is a parking lot with parking for approximately seventy cars. A drive-up facility with nine drive-up lanes and a drive-up automated teller machine ("ATM") is located across the street from First Mid Bank's main office.

First Mid Bank has a facility at 333 Broadway Avenue East, Mattoon, Illinois. The one-story office building contains approximately 7,600 square feet of office space. The main floor provides space for five teller windows, two private offices, a safe deposit vault and four drive-up lanes. There is adequate parking located adjacent to the building. A drive-up ATM is located adjacent to the building.

First Mid Bank leases a facility at 1504-A Lakeland Boulevard, Mattoon, Illinois that provides space for three tellers, two drive-up lanes and a drive-up ATM.

First Mid Bank owns a facility located at 1520 Charleston Avenue, Mattoon, Illinois, which is used as the corporate headquarters of the Company and is used by MIDS for its data processing and back room operations for the Company and First Mid Bank. The office building consists of a two-story structure with an occupied basement that has approximately 20,000 square feet of office space.

The Company owns a facility at 1500 Wabash Avenue, Mattoon, Illinois, which is used by the loan and deposit services departments of First Mid Bank. The office building consists of a two-story structure with a basement that has approximately 11,200 square feet of office space.

There are four additional ATMs located in Mattoon. They are located in the Administration building of Lake Land College, in the main lobby of Sarah Bush Lincoln Health Center, at R.R. Donnelley & Sons Co. on North Route 45 and County Market at 2000 Western Avenue.

Sullivan. First Mid Bank operates two locations in Sullivan, Illinois. The main office is located at 200 South Hamilton Street, Sullivan, Illinois. Its office building is a one-story structure containing approximately 11,400 square feet of office space with five teller windows, six private offices and four drive-up lanes. Adequate customer parking is available on two sides of the main office building. The second office is a leased facility at 435 South Hamilton, Sullivan, Illinois in the IGA. The facility has two teller stations, a vault, an ATM and a night depository. There is also a walk-up ATM located in the Sullivan Citgo Station at 105 West Jackson.

Neoga. First Mid Bank's office in Neoga, Illinois, is located at 102 East Sixth Street, Neoga, Illinois. The building consists of a one-story structure containing approximately 4,000 square feet of office space. The main office building provides space for four tellers in the lobby of the building, two drive-up tellers, four private offices, two night depositories, and an ATM. Adequate customer parking is available on three sides of the main office building.

Tuscola. First Mid Bank operates an office in Tuscola, Illinois, which is located at 410 South Main Street. The all brick building consists of a one-story structure with approximately 4,000 square feet of office space. This main office building provides for four lobby tellers, two drive-up tellers, four private offices, a conference room, four drive-through lanes, including one with a drive-up ATM and one with a drive-up night depository. Adequate customer parking is available outside the main entrance.

Charleston. First Mid Bank has three offices in Charleston, Illinois. The main office, acquired in March 1997, is located at 500 West Lincoln Avenue, Charleston, Illinois. This one-story facility contains approximately 8,400 square feet with five teller stations, eight private offices and four drive-up lanes.

A second facility is located at 701 Sixth Street, Charleston, Illinois. It is a one-story facility with an attached two-bay drive-up structure and consists of approximately 5,500 square feet of office space. Adequate parking is available to serve its customers. The office space is comprised of three teller stations, three private offices, storage area, and a night depository. Approximately 2,200 square feet of this building is rented out to non-affiliated companies.

The third facility consists of approximately 400 square feet of leased space at the Martin Luther King Student Union on the Eastern Illinois University campus. The facility has two walk-up teller stations and two sit-down teller/CSR stations.

Seven ATMs are located in Charleston. One drive-up ATM is located in the parking lot of the facility at 500 West Lincoln Avenue, one in the parking lot of Save-A-Lot at 1400 East Lincoln Avenue, and one drive-up ATM is located in the parking lot of the Sixth Street facility. The fourth is an off-site walk-up ATM located in the Student Union at Eastern Illinois University and the fifth is a walk-up ATM located in Lantz Arena at Eastern Illinois University. The sixth ATM is a drive-up unit located on the Eastern Illinois University campus in a parking lot at the corner of Ninth Street and Roosevelt and the seventh is a drive-up unit located on the Eastern Illinois University campus in a parking lot at the corner of Fourth Street and Roosevelt.

Champaign. First Mid Bank leases a facility at 2229 South Neil Street, Champaign, Illinois. The office space, comprised of approximately 3,496 square feet, contains six lobby teller windows, two drive-up lanes, one drive-up ATM, a night depository, four private offices, and a conference room. Adequate customer parking is available to serve customers.

Urbana. First Mid Bank owns a facility located at 601 South Vine Street, Urbana, Illinois. Its office building consists of a one-story structure and contains approximately 3,600 square feet. The office building provides space for three tellers, two private offices and two drive-up lanes. An ATM machine is located in front of the building. An adequate customer parking lot is located on the south side of the building.

Effingham. First Mid Bank operates a facility at 902 North Keller Drive, Effingham, Illinois. The building is a two-story structure with approximately 4,000 square feet of office space. This office space consists of four teller stations, three drive-up teller lanes, five private offices and a night depository. Adequate parking is available to customers in front of the facility.

First Mid Bank also owns property at 900 North Keller Drive, Effingham, Illinois that provides additional customer parking along with a drive-up ATM.

Altamont. First Mid Bank has a banking facility located at 101 West Washington Street, Altamont, Illinois. This building is a one-story structure that has approximately 4,300 square feet of office space. The office space consists of nine teller windows, three drive-up teller lanes (one of which facilitates an ATM), seven private offices, one conference room and a night depository. Adequate parking is available on three sides of the building.

Arcola. First Mid Bank leases a facility at 324 South Chestnut Street, Arcola, Illinois. This building is a one-story structure with approximately 1,140 square feet of office space. This office space consists of two lobby teller stations, one loan station, two drive-up teller lanes, one private office and a night depository. A drive-up ATM lane is available adjacent to the teller lanes. Adequate parking is available to customers in front of the facility. There are also two additional ATMs located at the Arcola Citgo Station on Route 133 at Interstate Five and the Arthur Citgo Station at 209 North Vine.

Monticello. First Mid Bank has two offices in Monticello. The main facility is located on the northeast corner of the historic town square at 100 West Washington Street. This building is a two-story structure that has 8,000 square feet of office space consisting of five teller stations, seven private offices, and a night depository. The second floor is furnished and the basement is used for storage. Adequate parking is available to customers in back of the facility.

A second facility is located at 219 West Center Street, Monticello, Illinois. It is a one-story facility with two lobby teller stations and an attached two-bay drive-up structure with a drive-up ATM and a night depository. Adequate parking is available to serve its customers.

DeLand. First Mid Bank has an office at 220 North Highway Avenue, DeLand, Illinois. It is a one-story structure with one private office, three teller stations and a night depository. A portion of the space is leased to an outside insurance agency. Adequate parking is available in front of the building.

Taylorville. First Mid Bank has a banking facility located at 200 North Main Street, Taylorville, Illinois. This one-story building has approximately 3,700 square feet with five teller stations, three private offices, one drive-up lane, and a finished basement. A drive-up ATM is located in the parking lot and adequate customer parking is available adjacent to the building.

Decatur. First Mid Bank leases a facility at 111 E. Main Street, Decatur, Illinois. The office space comprised of 4,340 square feet contains three lobby teller windows, two drive-up lanes, a night depository, three private offices, safe deposit and loan vaults, and a conference room. Customer parking is available adjacent to the building.

Highland. First Mid Bank owns a facility located at 12616 State Route 143, Highland, Illinois. The building is a two-story structure with approximately 6,720 square feet of office space, a portion of which is leased to an unaffiliated business. This office space consists of a customer service area and teller windows, three drive-up teller lanes, an ATM and four private offices. Adequate parking is available to serve customers.

First Mid Bank leases a facility located at 1301 Broadway, Highland, Illinois. The office space, comprised of 1300 square feet, contains three lobby teller windows, two drive-up lanes and one drive-up ATM, a night depository, two private offices, safe deposit and loan vaults and a conference room. Adequate parking is available to serve customers.

Pocahontas. First Mid Bank owns a facility located at 103 Park Street, Pocahontas, Illinois. The building is a one-story brick structure with approximately 3,360 square feet of office space. This office space consists of a customer processing room, three private offices and three bank vaults. Adequate parking is available to serve customers.

Maryville. First Mid leases a facility located at 2930 North Center Street, Maryville, Illinois. The office space, comprised of approximately 6,684 square feet, contains four lobby teller windows, including one sit-down teller, two drive-up lanes, one drive-up ATM, a night depository, three private offices, a vault, and a conference room. Adequate customer parking is available to serve customers.

Mansfield. First Mid Bank owns a facility at 1 Jefferson, Mansfield, Illinois. The building is a one-story structure with approximately 3,695 square feet of office space which contains a lobby with teller windows, one drive-up lane, three private offices, a vault, a conference room and a basement used for storage. Customer parking is available adjacent to the building.

Mahomet. First Mid Bank owns a facility located at 504 E. Oak Street, Mahomet, Illinois. The building is a one-story structure with approximately 3,045 square feet of office space which contains a lobby with teller windows, a drive-up lane, an ATM, two private offices, a vault, a conference room and a basement used for storage. Adequate customer parking is available to serve customers.

Weldon. First Mid Bank owns a facility located at Oak and Maple, Weldon, Illinois. The building is a two-story structure with approximately 5,964 square feet of office space which contains a lobby with teller windows, a drive-up lane, four private offices, two vaults, a conference room and a basement used for storage. Offices on the second floor have been leased to a separate entity. Adequate customer parking is available to serve customers.

Checkley (Mattoon). Checkley leases a facility located at 100 Lerna South, Mattoon, Illinois. The office space, comprised of approximately 8,829 square feet, contains ten offices, two conference rooms, a file room and an open work area that can accommodate nine workstations. Adequate parking is available to serve customers.

ITEM 3. LEGAL PROCEEDINGS

Since First Mid Bank acts as a depository of funds, it is named from time to time as a defendant in lawsuits (such as garnishment proceedings) involving claims to the ownership of funds in particular accounts. Management believes that all such litigation as well as other pending legal proceedings, in which the Company is involved, constitute ordinary routine litigation incidental to the business of the Company and that such litigation will not materially adversely affect the Company's consolidated financial condition or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

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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 647 shareholders of record as of December 31, 2006 and is included for quotation on the over-the-counter electronic bulletin board.

The following table shows the high and low bid prices per share of the Company's common stock for the indicated periods. These quotations represent inter-dealer prices without retail mark-ups, mark-downs or commissions and may not necessarily represent actual transactions.

| Quarter | High | Low |
|----------------|-------------|------------|
| 2006 | | |
| 4th | \$ 42.00 | \$ 40.80 |
| 3rd | \$ 42.00 | \$ 41.25 |
| 2nd | \$ 41.75 | \$ 40.00 |
| 1st | \$ 42.00 | \$ 40.00 |
| 2005 | | |
| 4th | \$ 41.50 | \$ 40.25 |
| 3rd | \$ 42.00 | \$ 40.10 |
| 2nd | \$ 40.90 | \$ 40.00 |
| 1st | \$ 41.00 | \$ 37.75 |

The following table sets forth the cash dividends per share on the Company's common stock for the last two years.

| Date Declared | Date Paid | Dividend Per Share |
|----------------------|------------------|---------------------------|
| 12-12-2006 | 1-08-2007 | \$.26 |
| 4-25-2006 | 6-15-2006 | \$.26 |
| 12-13-2005 | 1-09-2006 | \$.26 |
| 4-26-2005 | 6-15-2005 | \$.24 |

The Company's shareholders are entitled to receive such 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 First Mid Bank's dividend restrictions, see Item 1 - "Business" - "First Mid Bank" - "Dividends" and Note 17 - "Dividend Restrictions" herein. The Board of Directors of the Company declared cash dividends semi-annually during the two years ended December 31, 2006.

The following table summarizes share repurchase activity for the fourth quarter of 2006:

| 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 |
| October 1, 2006 - October 31, 2006 | -- | | -- | -- | \$ | 4,153,000 |
| November 1, 2006 - November 30, 2006 | 14,290 | \$ | 41.55 | 14,290 | \$ | 3,559,000 |
| December 1, 2006 - December 31, 2006 | 30,081 | \$ | 41.73 | 30,081 | \$ | 2,304,000 |
| Total | 44,371 | \$ | 41.67 | 44,371 | \$ | 2,304,000 |

On August 5, 1998, the Company announced a stock repurchase program of up to 3% of its common stock. In March 2000, the Board of Directors approved the repurchase of an additional 5% of the Company's common stock. In September 2001, the Board of Directors authorized the repurchase of \$3 million additional shares of the authorized common stock and in August 2002, the Board of Directors authorized the repurchase of \$5 million additional shares of the Company's common stock. In September 2003, the Board of Directors approved the repurchase of \$10 million additional shares of the Company's stock and on April 27, 2004, the Board approved the repurchase of \$5 million additional shares of the Company's common stock. On August 23, 2005, the Board approved the repurchase of \$5 million additional shares of the Company's common stock and on August 22, 2006, the Board approved the repurchase of \$5 million additional shares of the Company's common stock, bringing the aggregate total of purchases authorized on December 31, 2006 to 8%, or \$6.2 million, of the Company's common stock plus \$33 million of additional shares.

Subsequently, on February 27, 2007, the Board of Directors approved the repurchase of \$5 million additional shares of the Company's common stock, bringing the aggregate total of purchases authorized to 8%, or \$6.2 million, of the Company's common stock plus \$38 million of additional shares.

ITEM 6. SELECTED FINANCIAL DATA

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

| | 2006 | 2005 | 2004 | 2003 | 2002 |
|-------------------------------------------------------|------------|------------|------------|------------|------------|
| Summary of Operations | | | | | |
| Interest income | \$ 55,556 | \$ 44,580 | \$ 40,024 | \$ 38,938 | \$ 41,387 |
| Interest expense | 24,712 | 15,687 | 11,644 | 11,896 | 14,661 |
| Net interest income | 30,844 | 28,893 | 28,380 | 27,042 | 26,726 |
| Provision for loan losses | 760 | 1,091 | 588 | 1,000 | 1,075 |
| Other income | 13,380 | 12,518 | 11,639 | 12,255 | 10,394 |
| Other expense | 28,423 | 25,385 | 25,139 | 24,530 | 24,006 |
| Income before income taxes | 15,041 | 14,935 | 14,292 | 13,767 | 12,039 |
| Income tax expense | 5,032 | 5,128 | 4,541 | 4,674 | 4,005 |
| Net income | \$ 10,009 | \$ 9,807 | \$ 9,751 | \$ 9,093 | \$ 8,034 |
| Per Common Share Data (1) | | | | | |
| Basic earnings per share | \$ 2.31 | \$ 2.22 | \$ 2.17 | \$ 1.92 | \$ 1.60 |
| Diluted earnings per share | 2.27 | 2.16 | 2.13 | 1.88 | 1.58 |
| Dividends per common share | .52 | .50 | .45 | .43 | .33 |
| Book value per common share | 17.68 | 16.47 | 15.53 | 15.02 | 13.97 |
| Capital Ratios | | | | | |
| Total capital to risk-weighted assets | 10.91% | 11.87% | 11.71% | 10.61% | 10.35% |
| Tier 1 capital to risk-weighted assets | 10.10% | 11.14% | 10.94% | 9.83% | 9.64% |
| Tier 1 capital to average assets | 7.56% | 8.55% | 7.99% | 7.18% | 6.62% |
| Financial Ratios | | | | | |
| Net interest margin | 3.51% | 3.70% | 3.75% | 3.75% | 3.99% |
| Return on average assets | 1.07% | 1.18% | 1.20% | 1.17% | 1.11% |
| Return on average common equity | 13.31% | 13.64% | 14.24% | 13.11% | 11.82% |
| Dividend payout ratio | 22.51% | 22.55% | 20.92% | 22.57% | 20.92% |
| Average equity to average assets | 8.01% | 8.64% | 8.44% | 8.94% | 9.36% |
| Allowance for loan losses as a percent of total loans | 0.81% | 0.73% | 0.77% | 0.80% | 0.74% |
| Year End Balances | | | | | |
| Total assets | \$ 980,559 | \$ 850,573 | \$ 826,728 | \$ 793,981 | \$ 776,240 |
| Net loans | 717,692 | 631,707 | 590,539 | 547,647 | 489,071 |
| Total deposits | 770,595 | 649,069 | 650,240 | 614,992 | 613,452 |
| Total equity | 75,786 | 72,326 | 69,154 | 70,595 | 66,807 |
| Average Balances | | | | | |
| Total assets | \$ 938,784 | \$ 832,752 | \$ 811,061 | \$ 776,072 | \$ 727,986 |
| Net loans | 686,069 | 606,064 | 568,271 | 520,962 | 479,957 |
| Total deposits | 737,344 | 650,116 | 638,445 | 611,982 | 573,670 |
| Total equity | 75,174 | 71,911 | 68,459 | 69,349 | 67,989 |

(1) All share and per share data have been restated to reflect the 3-for-2 stock splits effective July 16, 2004.

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 for the years ended December 31, 2006, 2005 and 2004. 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 contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, 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 1995, and is including this statement for purposes of these safe harbor provisions. 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 uncertainties including: changes in interest rates, general economic conditions, 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, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning the Company and its business, including additional factors that could materially affect the Company's financial results, is included in Item 1A of this Annual Report on Form 10-K captioned "Risk Factors" and elsewhere in the filing and the Company's other filings with the Securities and Exchange Commission.

For the Years Ended December 31, 2006, 2005, and 2004

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 \$10.01 million, \$9.81 million, and \$9.75 million and diluted earnings per share was \$2.27, \$2.16, and \$2.13 for the years ended December 31, 2006, 2005, and 2004, respectively. The increase in net income in 2006 was primarily the result of higher net interest income and greater non-interest income. The increase in earnings per share in 2006 was the result of improved net income and a decrease in the number of shares outstanding due to share repurchases made through the Company's stock buy-back program. During 2006, the Company acquired 172,820 shares for a total investment of \$7,152,000. The following table shows the Company's annualized performance ratios for the years ended December 31, 2006, 2005 and 2004:

| | 2006 | 2005 | 2004 |
|----------------------------------|--------|--------|--------|
| Return on average assets | 1.07% | 1.18% | 1.20% |
| Return on average equity | 13.31% | 13.64% | 14.24% |
| Average equity to average assets | 8.01% | 8.64% | 8.44% |

Total assets at December 31, 2006, 2005, and 2004 were \$980.6 million, \$850.6 million, and \$826.7 million, respectively. The increase in net assets was primarily the result of the acquisition of Peoples during the second quarter of 2006. Net loan balances increased to \$715.5 million at December 31, 2006, from \$631.7 million and \$590.5 million at December 31, 2005 and 2004, respectively. The increase in 2006 of \$83.8 million or 13.3% was due to the acquisition of \$55.8 million of total net loans acquired from Peoples in the second quarter of 2006 and also to an increase in commercial real estate loans. Total deposit balances increased \$121.5 million to \$770.6 million at December 31, 2006 from \$649.1 million at December 31, 2005 and \$650.2 million at December 31, 2004. The increase in 2006 was primarily due to the acquisition of \$108.1 million of deposits acquired from Mansfield.

Net interest margin, defined as net interest income divided by average interest-earning assets, was 3.51% for 2006, 3.70% for 2005 and 3.75% for 2004. The decrease in net interest margin is attributable to a greater increase in borrowing and deposit rates compared to the increase in interest-earning asset rates. This is primarily due to the inversion of the interest rate yield curve where rates on short-term financial instruments have increased faster than rates on longer-term instruments.

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Net interest income increased from \$28.4 million in 2004 to \$28.9 million in 2005 and to \$30.8 million in 2006. This increase was the result of management's business development efforts that led to higher levels of average interest-earning assets of \$756.8 million in 2004, \$781.7 million in 2005 and \$877.1 million in 2006. This growth offset the factors previously mentioned which led to margin compression and led to higher levels of net interest income. The ability of the Company to continue to grow net interest income is largely dependent on management's ability to succeed in its overall business development efforts. Management expects these efforts to continue but will not compromise credit quality and prudent management of the maturities of interest-earning assets and interest-paying liabilities in order to achieve growth. Non-interest income increased to \$13.4 million in 2006 compared to \$12.5 million in 2005 and \$11.6 million in 2004. The primary reasons for this increase of \$.9 million or 6.9% were increases in trust revenues, insurance commissions and ATM and bankcard service fees during 2006 compared to 2005.

Non-interest expenses increased \$3 million, to \$28.4 million in 2006 compared to \$25.4 million in 2005 and \$25.1 million in 2004. The primary factor in the increase was due to additional salaries and benefits expense as a result of the acquisition of Mansfield, merit increases for continuing employees and \$178,000 of additional compensation expense related to the vesting of stock options recorded in 2006 in accordance with the provisions of SFAS 123R.

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

| | 2006 vs 005 | | 2005 vs 2004 |
|-------------------------------------------------|-------------|---------|--------------|
| Net interest income | \$ | 1,951 | \$ 513 |
| Provision for loan losses | | 331 | (503) |
| Other income, including securities transactions | | 862 | 879 |
| Other expenses | | (3,038) | (246) |
| Income taxes | | 96 | (587) |
| Increase in net income | \$ | 202 | \$ 56 |

Credit quality is an area of importance to the Company and the level of nonperforming loans and net charge-offs remained below peer banks in 2006. Year-end total nonperforming loans did not change materially with \$3.7 million at December 31, 2006 compared to \$3.5 million at December 31, 2005 and \$3.1 million at December 31, 2004. The Company's provision for loan losses was \$760,000 for 2006 compared to \$1,091,000 for 2005. During the year, a decline in credit quality of commercial loans of four borrowers secured by business assets and mortgage real estate loans of a single borrower resulted in charges to the allowance for loan losses of \$543,000 and accounted for the majority of the provision increase. At December 31, 2006, the composition of the loan portfolio remained similar to 2005. Loans secured by both commercial and residential real estate comprised 71% of the loan portfolio as of December 31, 2006 and 2005.

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, 2006, 2005, and 2004 was 10.10%, 11.14%, and 10.94%, respectively. The Company's total capital to risk weighted assets ratio at December 31, 2006, 2005, and 2004 was 10.91%, 11.87%, and 11.71%, respectively. The decrease in 2006 was primarily the result of an increase in risk-weighted assets and a decrease in tier I capital due to the acquisition of Mansfield. This was partially offset by the issuance of trust preferred securities by First Mid-Illinois Statutory Trust II ("Trust II"), which qualify as Tier I capital for the Company under Federal Reserve Board guidelines. The Trust invested the proceeds of the issuance in junior subordinated debentures of the Company. The increase in 2005 was primarily the result of an increase in retained earnings due to the Company's increase in net income.

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, 2006, 2005 and 2004 were \$131.9 million, \$117.8 million and \$94.2 million, respectively. See Note 12 - "Disclosure of Fair Values of Financial Instruments" and Note 18 - "Commitments and Contingent Liabilities" herein for further information.

Critical Accounting Policies

The Company has established various accounting policies that govern the application of accounting principles generally accepted in the United States 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.

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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. In estimating the allowance for loan losses, management utilizes historical experience, as well as other factors, including the effect of changes in the local real estate market on collateral values, the effect on the loan portfolio of current economic indicators and their probable impact on borrowers, and increases or decreases in nonperforming and impaired loans. Changes in these factors may cause management's estimate of the allowance to increase or decrease and result in adjustments to the Company's provision for loan losses. See "Loan Quality and Allowance for Loan Losses" and Note 1 - "Summary of Significant Accounting Policies" herein for a detailed description of the Company's estimation process and methodology related to the allowance for loan losses.

Mergers and Acquisitions

On May 1, 2006, the Company completed the acquisition, for \$24 million in cash, of all of the outstanding common stock of Mansfield and its wholly-owned subsidiary, Peoples, with locations in Mansfield, Mahomet and Weldon, Illinois, in order to expand its market presence in this area. The Company financed the purchase price through a dividend of \$5 million from First Mid Bank, an issuance of \$10 million of trust preferred securities and a \$9.5 million draw on the Company's line of credit with The Northern Trust Company. Following the completion of the acquisition during the third quarter of 2006, Mansfield merged with and into Peoples and Peoples merged with and into First Mid Bank. Following the completion of these mergers, Mansfield and Peoples ceased to exist and Peoples' operations were merged into First Mid Bank's.

The transaction has been accounted for as a purchase, and the results of operations of Mansfield and Peoples since the acquisition date have been included in the consolidated financial statements. See Note 20 - "Acquisitions" herein for further information.

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.

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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, 2006 | | | Year Ended December 31, 2005 | | | Year Ended December 31, 2004 | | |
|------------------------------------------------|---------------------------------|---------------------|-----------------|---------------------------------|---------------------|-----------------|---------------------------------|---------------------|-----------------|
| | Average Balance | Average Interest | Average Rate | Average Balance | Average Interest | Average Rate | Average Balance | Average Interest | Average Rate |
| ASSETS | | | | | | | | | |
| Interest-bearing deposits | \$ 628 | \$ 31 | 4.94% | \$ 1,330 | \$ 40 | 3.01% | \$ 4,729 | \$ 75 | 1.59% |
| Federal funds sold | 5,517 | 276 | 5.00% | 9,184 | 285 | 3.10% | 8,813 | 103 | 1.17% |
| Investment securities | | | | | | | | | |
| Taxable | 161,351 | 7,490 | 4.64% | 140,972 | 5,313 | 3.77% | 143,568 | 4,860 | 3.39% |
| Tax-exempt (1) | 17,900 | 771 | 4.31% | 19,435 | 871 | 4.48% | 26,814 | 1,193 | 4.45% |
| Loans (2) (3) | 691,726 | 46,988 | 6.79% | 610,781 | 38,071 | 6.23% | 572,836 | 33,793 | 5.90% |
| Total earning assets | 877,122 | 55,556 | 6.33% | 781,702 | 44,580 | 5.70% | 756,760 | 40,024 | 5.29% |
| Cash and due from banks | 18,974 | | | 17,828 | | | 18,870 | | |
| Premises and equipment | 16,082 | | | 15,115 | | | 15,692 | | |
| Other assets | 32,263 | | | 22,824 | | | 24,304 | | |
| Allowance for loan losses | (5,657) | | | (4,717) | | | (4,565) | | |
| Total assets | \$ 938,784 | | | \$ 832,752 | | | \$ 811,061 | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | | | | | |
| Interest-bearing deposits | | | | | | | | | |
| Demand deposits | \$ 246,035 | 5,319 | 2.16% | \$ 229,532 | 2,975 | 1.30% | \$ 230,300 | 1,568 | 0.68% |
| Savings deposits | 62,279 | 323 | 0.52% | 59,830 | 248 | 0.41% | 61,144 | 236 | 0.39% |
| Time deposits | 323,283 | 12,944 | 4.00% | 271,161 | 8,496 | 3.13% | 261,564 | 7,318 | 2.80% |
| Securities sold under agreements to repurchase | 55,389 | 2,411 | 4.35% | 57,799 | 1,496 | 2.59% | 55,645 | 455 | 0.82% |
| FHLB advances | 34,063 | 1,562 | 4.59% | 31,545 | 1,536 | 4.87% | 27,117 | 1,484 | 5.47% |
| Federal funds purchased | 3,432 | 159 | 4.63% | 874 | 33 | 3.78% | 218 | 3 | 1.38% |
| Subordinated debentures | 17,367 | 1,315 | 7.57% | 10,310 | 643 | 6.24% | 8,704 | 382 | 4.39% |
| Other debt | 10,611 | 679 | 6.40% | 5,711 | 260 | 4.55% | 7,161 | 198 | 2.76% |
| Total interest-bearing liabilities | 752,459 | 24,712 | 3.28% | 666,762 | 15,687 | 2.35% | 651,853 | 11,644 | 1.79% |
| | 105,747 | | | 89,593 | | | 85,437 | | |

| | | | |
|--------------------------------------|------------|------------|------------|
| Demand deposits | | | |
| Other liabilities | 5,404 | 4,486 | 5,312 |
| Stockholders' equity | 75,174 | 71,911 | 68,459 |
| Total liabilities & equity | \$ 938,784 | \$ 832,752 | \$ 811,061 |
| Net interest income | \$ 30,844 | \$ 28,893 | \$ 28,380 |
| Net interest spread | | 3.05% | 3.35% |
| Impact of non-interest bearing funds | | .46% | .25% |
| Net yield on interest-earning assets | | 3.51% | 3.75% |

(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.

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):

| | 2006 Compared to 2005 | | | 2005 Compared to 2004 | | |
|--------------------------------------|-----------------------|----------|----------|-----------------------|----------|------------|
| | Increase - (Decrease) | | | Increase - (Decrease) | | |
| | Total | Volume | Rate | Total | Volume | Rate |
| | Change | (1) | (1) | Change | (1) | (1) |
| Earning Assets: | | | | | | |
| Interest-bearing deposits | \$ (9) | \$ (27) | \$ 18 | \$ (35) | \$ 175 | \$ (210) |
| Federal funds sold | (9) | (141) | 132 | 182 | 4 | 178 |
| Investment securities: | | | | | | |
| Taxable | 2,177 | 838 | 1,339 | 453 | (87) | 540 |
| Tax-exempt (2) | (100) | (67) | (33) | (322) | (331) | 9 |
| Loans (3) | 8,917 | 5,314 | 3,603 | 4,278 | 2,320 | 1,958 |
| Total interest income | 10,976 | 5,917 | 5,059 | 4,556 | 2,081 | 2,475 |
| Interest-Bearing Liabilities: | | | | | | |
| Interest-bearing deposits | | | | | | |
| Demand deposits | 2,344 | 230 | 2,114 | 1,407 | (5) | 1,412 |
| Savings deposits | 75 | 10 | 65 | 12 | (9) | 21 |
| Time deposits | 4,448 | 1,818 | 2,630 | 1,178 | 280 | 898 |
| Securities sold under | | | | | | |
| agreements to repurchase | 915 | (64) | 979 | 1,041 | 19 | 1,022 |
| FHLB advances | 26 | 118 | (92) | 52 | 159 | (107) |
| Federal funds purchased | 126 | 118 | 8 | 30 | 19 | 11 |
| Subordinated debentures | 672 | 512 | 160 | 261 | 80 | 181 |
| Other debt | 419 | 284 | 135 | 62 | (28) | 90 |
| Total interest expense | 9,025 | 3,026 | 5,999 | 4,043 | 515 | 3,528 |
| Net interest income | \$ 1,951 | \$ 2,891 | \$ (940) | \$ 513 | \$ 1,566 | \$ (1,053) |

(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 \$1,951,000, or 6.8% in 2006, compared to an increase of \$513,000, or 1.8% in 2005. The increases in net interest income in 2006 and 2005 were primarily due to growth in interest-earning assets primarily composed of loan growth that was offset by an increase in the cost of interest-bearing liabilities.

In 2006, average earning assets increased by \$95.4 million, or 12.2%, and average interest-bearing liabilities increased \$85.7 million or 12.9% compared with 2005. In 2005, average earning assets increased by \$24.9 million, or 3.3%, and average interest-bearing liabilities increased \$14.9 million or 2.3% compared with 2004. Changes in average balances are shown below:

Ø Average loans increased by \$80.9 million or 13.3% in 2006 compared to 2005. In 2005, average loans increased by \$37.9 million or 6.6% compared to 2004.

Ø Average securities increased by \$18.8 million or 11.7% in 2006 compared to 2005. In 2005, average securities increased by \$10 million or 5.9% compared to 2004.

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Ø Average interest-bearing deposits increased by \$71.1 million or 12.7% in 2006 compared to 2005. In 2005, average interest-bearing deposits increased by \$7.5 million or 1.4% compared to 2004.

Ø Average securities sold under agreements to repurchase decreased by \$2.4 million or 4.2% in 2006 compared to 2005. In 2005, average securities sold under agreements to repurchase increased by \$2.2 million or 3.9% compared to 2004.

Ø Average borrowings and other debt increased by \$17 million or 35% in 2006 compared to 2005. In 2005, average borrowings and other debt increased by \$5.2 million or 12% compared to 2004.

Ø The federal funds rate increased to 5.25% at December 31, 2006 from 4.50% at December 31, 2005 and from 2.25% at December 31, 2004.

Ø Net interest margin decreased to 3.51% compared to 3.70% in 2005 and 3.75% in 2004. Asset yields increased by 63 basis points in 2006, while interest-bearing liabilities increased by 149 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 (TE) 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 34% (referred to as the tax equivalent adjustment). The TE adjustments to net interest income for 2006, 2005 and 2004 were \$397,000, \$449,000 and \$615,000, respectively. The net yield on interest-earning assets (TE) was 3.56% in 2006, 3.75% in 2005 and 3.83% in 2004.

Provision for Loan Losses

The provision for loan losses in 2006 was \$760,000 compared to \$1,091,000 in 2005 and \$588,000 in 2004. Nonperforming loans increased to \$3,668,000 at December 31, 2006 from \$3,458,000 and \$3,106,000 at December 31, 2005 and 2004, respectively. Net charge-offs were \$937,000 during 2006, \$1,064,000 during 2005, and \$393,000 during 2004. For information on loan loss experience and nonperforming loans, see “Nonperforming Loans” 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 | | | | |
|-----------------------|----------------------------------|-------------|-------------|-------------|-------------|
| | 2006 | 2005 | 2004 | 2006 | 2005 |
| Trust | \$ 2,489 | \$ 2,356 | \$ 2,254 | \$ 133 | \$ 102 |
| Brokerage | 533 | 383 | 428 | 150 | (45) |
| Insurance commissions | 1,689 | 1,567 | 1,447 | 122 | 120 |
| Service charges | 5,308 | 4,719 | 4,746 | 589 | (27) |
| Securities gains | 164 | 373 | 92 | (209) | 281 |
| Mortgage banking | 394 | 742 | 522 | (348) | 220 |
| Other | 2,803 | 2,378 | 2,150 | 425 | 228 |
| Total other income | \$ 13,380 | \$ 12,518 | \$ 11,639 | \$ 862 | \$ 879 |

Total non-interest income increased to \$13,380,000 in 2006 compared to \$12,518,000 in 2005 and \$11,639,000 in 2004. The primary reasons for the more significant year-to-year changes in other income components are as follows:

Ø Trust revenues increased \$133,000 or 5.6% to \$2,489,000 in 2006 from \$2,356,000 in 2005 and \$2,254,000 in 2004. Approximately 50 percent of trust revenue is market value dependent. The increase in trust revenues was the result of new business and an increase in equity prices.

Ø Revenue from brokerage annuity sales increased \$150,000 or 39.2% to \$533,000 in 2006 from \$383,000 in 2005 and \$428,000 in 2004 as a result of a greater commissions received on sales of annuities.

Ø Insurance commissions increased \$122,000 or 7.8% to \$1,689,000 in 2006 from \$1,567,000 in 2005 and \$1,447,000 in 2004 due to an increase in commissions received on sales of business property and casualty insurance.

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Ø Fees from service charges increased \$589,000 or 12.5% to \$5,308,000 in 2006 from \$4,719,000 in 2005 and \$4,746,000 in 2004. This was primarily the result of an increase in the number of overdrafts and an increase in the per overdraft fee to \$25 from \$22.50.

Ø Net securities gains in 2006 were \$164,000 compared to net securities gains of \$373,000 in 2005, and \$92,000 in 2004. Several securities in the investment portfolio were sold to improve the overall portfolio mix and the margin in 2006, 2005 and 2004.

Ø Mortgage banking income decreased \$348,000 or 46.9% to \$394,000 in 2006 from \$742,000 in 2005 and \$522,000 in 2004. This decrease was due to the decline in volume of fixed rate loans originated and sold by First Mid Bank. Loans sold balances are as follows:

- Ø \$34 million (representing 322 loans) in 2006
- Ø \$63 million (representing 605 loans) in 2005
- Ø \$42 million (representing 441 loans) in 2004

Ø Other income increased \$425,000 or 17.9% to \$2,803,000 in 2006 from \$2,378,000 in 2005 and \$2,150,000 in 2004. The increase was primarily due to increased ATM service 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 | | | | | |
|-----------------------------------|----------------------------------|-----------|-------------|----------|-------------|--|
| | 2006 | | 2005 | | 2004 | |
| Salaries and benefits | \$ 15,418 | \$ 13,310 | \$ 13,626 | \$ 2,108 | \$ (316) | |
| Occupancy and equipment | 4,797 | 4,401 | 4,259 | 396 | 142 | |
| Amortization of other intangibles | 761 | 568 | 623 | 193 | (55) | |
| Stationery and supplies | 583 | 522 | 518 | 61 | 4 | |
| Legal and professional fees | 1,324 | 1,553 | 1,173 | (229) | 380 | |
| Marketing and promotion | 945 | 728 | 771 | 217 | (43) | |
| Other | 4,595 | 4,303 | 4,169 | 292 | 134 | |
| Total other expense | \$ 28,423 | \$ 25,385 | \$ 25,139 | \$ 3,038 | \$ 246 | |

Total non-interest expense increased to \$28,423,000 in 2006 from \$25,385,000 in 2005 and \$25,139,000 in 2004. The primary reasons for the more significant year-to-year changes in other expense components are as follows:

Ø Salaries and employee benefits, the largest component of other expense, increased \$2,108,000 or 15.8% to \$15,418,000 in 2006 from \$13,310,000 in 2005 and \$13,626,000 in 2004. The increase in 2006 was as a result of the acquisition of Mansfield, merit increases for continuing employees and \$178,000 of additional compensation expense related to the vesting of stock options recorded in 2006 in accordance with the provisions of SFAS 123R. There were 347 full-time equivalent employees, of which 29 resulted from acquisition of Mansfield, at December 31, 2006 compared to 318 at December 31, 2005 and 317 at December 31, 2004.

Ø Occupancy and equipment expense increased \$396,000 or 9.0% to \$4,797,000 in 2006 from \$4,401,000 in 2005 and \$4,259,000 in 2004. These increases were due to an increase in occupancy expenses for Mansfield in 2006, and the new office location of Checkley and the Highland branch facility that were opened in 2005.

Ø

Amortization of other intangibles expense increased \$193,000 in 2006. This was a result of additional core deposit intangible amortization expense resulting from the acquisition of Mansfield.

- Ø Other operating expenses increased \$292,000 or 6.8% to 4,595,000 in 2006 from \$4,303,000 in 2005 and \$4,169,000 in 2004. The increase in 2006 resulted from an increase in expenses related to other real estate owned, ATM and debit card fee expense and increased expenses following the acquisition of Mansfield. The increase in 2005 resulted from an increase in expenses related to other real estate owned.
- Ø On a net basis, all other categories of operating expenses increased \$49,000 or 1.7% to \$2,852,000 in 2006 from \$2,803,000 in 2005 and \$2,462,000 in 2004. The increase in 2006 was primarily due to increased expenses following the acquisition of Mansfield. The increase in 2005 was primarily due to increases in various professional fees.

Income Taxes

Income tax expense amounted to \$5,032,000 in 2006 compared to \$5,128,000 in 2005 and \$4,541,000 in 2004. Effective tax rates were 33.5%, 34.3% and 31.8%, respectively, for 2006, 2005 and 2004. The change in the effective tax rate in 2006 is due to a \$142,000 reduction in the state tax expense accrual as a result of amending the 2004 state income tax return for a greater deduction in enterprise zone interest filed during the first quarter of 2006. This resulted in a \$92,000 net reduction in tax expense. Additional reduction in state tax expense for 2006 resulted from an increase in deductible enterprise zone loans.

Analysis of Balance Sheet**Loans**

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

| | 2006 | 2005 | 2004 | 2003 | 2002 |
|---------------------------|------------|------------|------------|------------|------------|
| Real estate - mortgage | \$ 510,735 | \$ 450,435 | \$ 427,154 | \$ 390,841 | \$ 340,033 |
| Commercial & agricultural | 161,085 | 150,598 | 137,733 | 131,609 | 127,065 |
| Installment | 47,017 | 34,385 | 30,587 | 28,932 | 31,119 |
| Other | 4,731 | 2,715 | 2,375 | 1,442 | 1,647 |
| Total loans | \$ 723,568 | \$ 638,133 | \$ 597,849 | \$ 552,824 | \$ 499,864 |

Loan balances have increased over the past few years primarily as a result of increased commercial real estate loans and commercial operating loans. The increase in commercial real estate loans outstanding has been the result of demand for credit for commercial real estate projects in central Illinois and business development efforts. Also, corporate borrowers have required additional capital for inventory and company expansion. The growth has been primarily in the communities of Champaign, Decatur, Effingham, Highland, and Maryville.

Loan balances increased by \$85.4 million or 13.4% from December 31, 2005 to December 31, 2006 primarily as a result of the acquisition of Mansfield which resulted in an increase of approximately \$55.8 million and also due to an additional increase in commercial real estate loan balances of \$18.1 million. In total commercial real estate loan balances increased to \$309.9 million at December 31, 2006 from \$282.5 million at December 31, 2005. Loans secured by apartment buildings and hotels comprised the largest percentage of the growth in commercial real estate loans. Balances of loans sold into the secondary market were \$34 million in 2006, compared to \$63 million in 2005. The balance of real estate loans held for sale, included in the balances shown above, amounted to \$2,234,000 and \$1,778,000 as of December 31, 2006 and 2005, respectively.

At December 31, 2006, the Company had loan concentrations in agricultural industries of \$109.7 million, or 15.2%, of outstanding loans and \$92.3 million, or 14.5%, at December 31, 2005. In addition, the Company had loan concentrations in the following industries as of December 31, 2006 and 2005 (dollars in thousands):

| | 2006 | | 2005 | |
|----------------------------------------|-------------------|---------------------|-------------------|---------------------|
| | Principal balance | % Outstanding loans | Principal balance | % Outstanding loans |
| Operators of non-residential buildings | \$ 31,527 | 4.36% | \$ 22,446 | 3.52% |
| Apartment building owners | 37,933 | 5.24% | 40,843 | 6.40% |

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|---------------------------------|--------|-------|--------|-------|
| Motels, hotels & tourist courts | 28,064 | 3.88% | 28,054 | 4.40% |
| Subdividers & developers | 34,872 | 4.82% | 26,397 | 4.14% |

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

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The following table presents the balance of loans outstanding as of December 31, 2006, by maturities (in thousands):

| | Maturity (1) | | | | Total |
|---------------------------|------------------------|------------------------------|-----------------|----|---------|
| | One year or less(2) | Over 1 through 5 years | Over 5 years | | |
| Real estate - mortgage | \$ 147,860 | \$ 319,941 | \$ 42,934 | \$ | 510,735 |
| Commercial & agricultural | 113,409 | 44,114 | 3,562 | | 161,085 |
| Installment | 22,734 | 24,023 | 260 | | 47,017 |
| Other | 973 | 2,368 | 1,390 | | 4,731 |
| Total loans | \$ 284,976 | \$ 390,446 | \$ 48,146 | \$ | 723,568 |

(1) Based upon remaining maturity.

(2) Includes demand loans, past due loans and overdrafts.

As of December 31, 2006, loans with maturities over one year consisted of \$368 million in fixed rate loans and \$71 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 rollovers and borrower requests, which are handled on a case-by-case basis.

Nonperforming Loans

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 “renegotiated loans”.

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

| | December 31, | | | | |
|--------------------------------------------------------------------------|--------------|----------|----------|----------|----------|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| Nonaccrual loans | \$ 3,639 | \$ 3,458 | \$ 3,106 | \$ 3,296 | \$ 2,961 |
| Renegotiated loans which are performing in accordance with revised terms | 29 | - | - | 35 | 188 |
| Total nonperforming loans | \$ 3,668 | \$ 3,458 | \$ 3,106 | \$ 3,331 | \$ 3,149 |

At December 31, 2006, \$1,229,000 of the nonperforming loans resulted from collateral-dependent loans to two borrowers. The \$181,000 increase in nonaccrual loans during the year resulted from the net of \$1,642,000 of loans put on nonaccrual status, offset by \$127,000 of loans transferred to other real estate owned, \$220,000 of loans charged off and \$1,114,000 of loans becoming current or paid-off.

Interest income that would have been reported if nonaccrual and renegotiated loans had been performing totaled \$123,000, \$99,000 and \$169,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

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 or earlier when, in the opinion of management, there is reasonable doubt as to the timely collection of interest or principal. 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.

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. 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 east central 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, 2006, the Company's loan portfolio included \$109.7 million of loans to borrowers whose businesses are directly related to agriculture. The balance increased \$17.4 million from \$92.3 million at December 31, 2005. While the Company adheres to sound underwriting practices, including collateralization of loans, any extended period of low commodity prices, 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 \$28.1 million of loans to motels, hotels and tourist courts. 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 non-performing loans to this business segment and potentially in loan losses. The Company also has \$31.5 million of loans to operators of non-residential buildings, \$37.9 million of loans to apartment building owners and \$34.9 million of loans to subdividers and developers. A significant widespread decline in real estate values could result in an increase in non-performing loans to this segment and potentially in loan losses.

Loan loss experience for the past five years are summarized as follows (dollars in thousands):

| | 2006 | 2005 | 2004 | 2003 | 2002 |
|---------------------------------------------------|------------|------------|------------|------------|------------|
| Average loans outstanding, net of unearned income | \$ 691,726 | \$ 610,781 | \$ 572,836 | \$ 525,095 | \$ 483,764 |
| Allowance-beginning of year | \$ 4,648 | \$ 4,621 | \$ 4,426 | \$ 3,723 | \$ 3,702 |
| Balance added through acquisitions | 1,405 | - | - | - | - |
| Charge-offs: | | | | | |
| Commercial, financial and agricultural | 595 | 757 | 436 | 589 | 673 |
| Real estate-mortgage | 231 | 122 | 23 | 50 | 200 |
| Installment | 142 | 278 | 129 | 139 | 255 |
| Other | 188 | 130 | - | - | - |

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|--------------------------------------------------------------------------|----------|----------|----------|----------|----------|
| Total charge-offs | 1,156 | 1,287 | 588 | 778 | 1,128 |
| Recoveries: | | | | | |
| Commercial, financial and agricultural | 30 | 75 | 146 | 427 | 12 |
| Real estate-mortgage | 8 | 63 | - | 15 | 17 |
| Installment | 49 | 42 | 49 | 39 | 45 |
| Other | 132 | 43 | - | - | - |
| Total recoveries | 219 | 223 | 195 | 481 | 74 |
| Net charge-offs | 937 | 1,064 | 393 | 297 | 1,054 |
| Provision for loan losses | 760 | 1,091 | 588 | 1,000 | 1,075 |
| Allowance-end of year | \$ 5,876 | \$ 4,648 | \$ 4,621 | \$ 4,426 | \$ 3,723 |
| Ratio of net charge-offs to average loans | .14% | .17% | .07% | .06% | .22% |
| Ratio of allowance for loan losses to loans outstanding (at end of year) | .81% | .73% | .77% | .80% | .74% |
| Ratio of allowance for loan losses to nonperforming loans | 160.2% | 134.4% | 148.8% | 132.9% | 118.2% |

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The Company minimizes credit risk by adhering to sound underwriting and credit review policies. These policies are reviewed at least annually, and the Board of Directors approves all changes. 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 monthly basis, the Board of Directors reviews the status of problem loans. In addition to internal policies and controls, regulatory authorities periodically review asset quality and the overall adequacy of the allowance for loan losses.

During 2006, the Company had net charge-offs of \$937,000 compared to \$1,064,000 in 2005 and \$393,000 in 2004. During 2006, the Company's significant charge-offs included \$565,000 on commercial loans of five borrowers and \$168,000 of commercial and real estate mortgage loans of one borrower. During 2005, the Company's significant charge-offs included \$408,000 on two commercial loans secured by business assets and one secured by commercial real estate. The Company also recovered \$56,000 on a commercial real estate loan that had been charged-off in a prior period. During 2004, significant charge-offs included \$118,000 on two commercial loans of a single borrower and \$124,000 on two commercial real estate loans of a single borrower. The Company also recovered \$85,000 in interest on an agricultural real estate loan that had been charged-off in a prior period and \$68,500 on two commercial real estate loans that were previously charged-off.

At December 31, 2006, the allowance for loan losses amounted to \$5,876,000, or .81% of total loans, and 160.2% of nonperforming loans. At December 31, 2005, the allowance was \$4,648,000, or .73% of total loans, and 134.4% of nonperforming loans. The ratio of the allowance for loan losses to total loans has been consistent over the past five years ranging from .73% to .81%.

The allowance for loan losses, in management's judgment, is allocated as follows to cover probable loan losses (dollars in thousands):

| | December 31, 2006 | | December 31, 2005 | | December 31, 2004 | |
|----------------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| | Allowance for loan losses | % of loans to total loans | Allowance for loan losses | % of loans to total loans | Allowance for loan losses | % of loans to total loans |
| Real estate-mortgage | \$ 215 | 70.6% | \$ 134 | 70.6% | \$ 240 | 71.4% |
| Commercial, financial and agricultural | 4,002 | 22.3% | 3,249 | 23.6% | 3,124 | 23.1% |
| Installment | 382 | 6.5% | 319 | 5.4% | 150 | 5.1% |
| Other | 26 | .6% | 18 | .4% | - | .4% |
| Total allocated | 4,625 | | 3,720 | | 3,514 | |
| Unallocated | 1,251 | N/A | 928 | N/A | 1,107 | N/A |
| Allowance at end of Year | \$ 5,876 | 100.0% | \$ 4,648 | 100.0% | \$ 4,621 | 100.0% |

| | December 31, 2003 | | December 31, 2002 | |
|----------------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| | Allowance for loan losses | % of loans to total loans | Allowance for loan losses | % of loans to total loans |
| Real estate-mortgage | \$ 219 | 70.7% | \$ 215 | 68.1% |
| Commercial, financial and agricultural | 2,912 | 23.8% | 2,882 | 25.4% |
| Installment | 154 | 5.2% | 190 | 6.2% |
| Other | - | .3% | - | .3% |

| | | | | |
|---------------------|----------|--------|----------|--------|
| Total allocated | 3,285 | | 3,287 | |
| Unallocated | 1,141 | N/A | 436 | N/A |
| Allowance at end of | | | | |
| year | \$ 4,426 | 100.0% | \$ 3,723 | 100.0% |

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 unallocated allowance represents an estimate of the probable, inherent, but yet undetected, losses in the loan portfolio. It is based on factors that cannot necessarily be associated with a specific credit or loan category and represents management's estimate to ensure that the overall allowance of loan losses appropriately reflects a margin for the imprecision necessarily inherent in the estimates of expected credit losses.

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Securities

The Company's overall investment goal is to maximize earnings while maintaining liquidity in securities having minimal credit risk. 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 year-end amortized cost of the Company's securities for the last three years (dollars in thousands):

| | December 31, | | | | | |
|---------------------------------------------------------------------------------------|-------------------------------|-------|------------|------------------------------|------------|------------------------------|
| | 2006 | | 2005 | | 2004 | |
| | Weighted Average Amount | Yield | Amount | Weighted Average Yield | Amount | Weighted Average Yield |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | \$ 140,924 | 4.81% | \$ 108,506 | 3.74% | \$ 92,369 | 2.81% |
| Obligations of states and political subdivisions | 16,637 | 4.17% | 16,829 | 4.54% | 25,133 | 4.54% |
| Mortgage-backed securities | 15,491 | 4.50% | 20,046 | 4.34% | 34,032 | 3.82% |
| Other securities | 12,505 | 6.56% | 13,083 | 6.21% | 17,817 | 6.02% |
| Total securities | \$ 185,557 | 4.85% | \$ 158,464 | 4.10% | \$ 169,351 | 3.61% |

At December 31, 2006, the Company's investment portfolio reflected a decrease in mortgage-backed securities and obligations of states and political subdivisions securities and an increase in U.S. Treasury securities and obligations of U.S. government corporations and agencies. There was also a decrease in other securities. This change in the portfolio mix improved the characteristics of the portfolio relating to interest rate risk exposure and portfolio yield.

The following table indicates the expected maturities of investment securities classified as available-for-sale and held-to-maturity, presented at amortized cost, at December 31, 2006 (dollars in thousands) and the weighted average yield for each range of maturities. Mortgage-backed securities are aged according to their weighted average life. All other securities are shown at their contractual maturity.

| | One year or less | After 1 through 5 years | After 5 through 10 years | After 10 years | Total |
|---------------------------------------------------------------------------------------|------------------------|-------------------------------|--------------------------------|----------------------|------------|
| Available-for-sale: | | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | \$ 20,841 | \$ 85,187 | \$ 33,940 | \$ 956 | \$ 140,924 |
| Obligations of state and political subdivisions | 1,525 | 5,899 | 3,955 | 3,935 | 15,314 |
| Mortgage-backed securities | 553 | 14,938 | - | - | 15,491 |
| Other securities | 500 | - | 2,500 | 9,505 | 12,505 |
| Total investments | \$ 23,419 | \$ 106,024 | \$ 40,395 | \$ 14,396 | \$ 184,234 |
| Weighted average yield | 4.76% | 4.51% | 5.63% | 5.79% | 4.92% |
| Full tax-equivalent yield | 4.87% | 4.61% | 5.78% | 6.29% | 5.07% |

Held-to-maturity:

| | | | | | | | | | | |
|-------------------------------------------------|----|-------|----|-------|----|-------|----|-------|----|-------|
| Obligations of state and political subdivisions | \$ | 145 | \$ | 510 | \$ | 344 | \$ | 324 | \$ | 1,323 |
| Weighted average yield | | 5.36% | | 5.55% | | 5.29% | | 5.47% | | 5.44% |
| Full tax-equivalent yield | | 7.89% | | 8.17% | | 7.63% | | 8.05% | | 7.97% |

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The weighted average yields are calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of each security. Full tax-equivalent yields have been calculated using a 34% tax rate. With the exception of obligations of the U.S. Treasury and other U.S. government agencies and corporations, there were no investment securities of any single issuer the book value of which exceeded 10% of stockholders' equity at December 31, 2006.

At December 31, 2006, there were five obligations of states and political subdivisions with a fair value of \$1,591,000 and unrealized losses of \$12,000, six mortgage-backed securities with a fair value of \$13,550,000 and unrealized losses of \$332,000, and ten obligations of U.S. government agencies with a fair value of \$51,637,000 and unrealized losses of \$782,000, in a continuous unrealized loss position for twelve months or more. This position is due to short-term and intermediate rates increasing since the purchase of these securities resulting in the market value of the security being lower than book value. Management does not believe any individual unrealized loss as of December 31, 2006 represents an other than temporary impairment.

Investment securities carried at approximately \$158,547,000 and \$136,787,000 at December 31, 2006 and 2005, respectively, were pledged to secure public deposits and repurchase agreements and for other purposes as permitted or required by law.

Deposits

Funding of the Company's earning assets is substantially provided by a combination of consumer, commercial and public fund deposits. The Company continues to focus its strategies and emphasis on retail core deposits, the major component of funding sources. The following table sets forth the average deposits and weighted average rates for 2006, 2005 and 2004 (dollars in thousands):

| | 2006 | | 2005 | | 2004 | |
|------------------------|--------------------------------|-----------------|--------------------|-----------------------------|--------------------|-----------------------------|
| | Weighted Average Balance | Average Rate | Average Balance | Weighted Average Rate | Average Balance | Weighted Average Rate |
| Demand deposits: | | | | | | |
| Non-interest bearing | \$ 105,744 | - | \$ 89,593 | - | \$ 85,437 | - |
| Interest bearing | 246,035 | 2.16% | 229,532 | 1.30% | 230,300 | .68% |
| Savings | 62,279 | .52% | 59,830 | .41% | 61,144 | .39% |
| Time deposits | 323,283 | 4.00% | 271,161 | 3.13% | 261,564 | 2.80% |
| Total average deposits | \$ 737,341 | 2.52% | \$ 650,116 | 1.80% | \$ 638,445 | 1.43% |

| | December 31, | | |
|-------------------------------------------|--------------|------------|------------|
| (dollars in thousands) | 2006 | 2005 | 2004 |
| High month-end balances of total deposits | \$ 799,002 | \$ 677,872 | \$ 668,540 |
| Low month-end balances of total deposits | 651,392 | 627,107 | 620,200 |

In 2006, the average balance of deposits increased by \$87.2 million from 2005. The increase was primarily attributable to deposits acquired in the acquisition of Mansfield and to a promotion run in the first quarter of 2006. Average non-interest bearing deposits increased by \$16.1 million, average money market account balances increased by \$16.8 million, and consumer CD balances increased by \$52.1 million offset by a decline in brokered CD balances. In 2005, the average balance of deposits increased by \$11.7 million from 2004. The increase was primarily attributable to growth in interest-bearing deposits, including money market accounts, Club 50 accounts, and time

deposit balances (“CD”). Average money market account balances increased by \$4.4 million, average balances in the Club 50 accounts increased by \$3.9 million, and consumer CD balances increased by \$13.2 million, partially offset by a decline in brokered CD balances and public time deposits.

In 2006, the Company’s significant deposits included brokered CDs, time deposits with the State of Illinois, and deposit relationships with two public entities. The Company had six brokered CDs at various maturities with a total balance of \$22.4 million as of December 31, 2006. State of Illinois time deposits maintained with the Company totaled \$3.1 million as of December 31, 2006. These balances are subject to bid annually. In addition, the Company maintains account relationships with various public entities throughout its market areas. Three public entities had total balances of \$16.7 million in various checking accounts and time deposits as of December 31, 2006. These balances are subject to change depending upon the cash flow needs of the public entity.

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The following table sets forth the maturity of time deposits of \$100,000 or more (in thousands):

| | December 31, | | |
|--------------------------|--------------|------------|------------|
| | 2006 | 2005 | 2004 |
| 3 months or less | \$ 38,468 | \$ 15,947 | \$ 26,916 |
| Over 3 through 6 months | 20,004 | 23,593 | 17,560 |
| Over 6 through 12 months | 45,532 | 34,944 | 22,826 |
| Over 12 months | 11,896 | 28,950 | 48,031 |
| Total | \$ 115,900 | \$ 103,434 | \$ 115,333 |

The balance of time deposits of \$100,000 or more increased by \$12.5 million from December 31, 2005 to December 31, 2006. The increase in balances was primarily attributable to time deposits acquired in the acquisition of Mansfield and to a promotion run in the first quarter of 2006. The balance of time deposits of \$100,000 or more decreased by \$11.9 million from December 31, 2004 to December 31, 2005. The decrease in balances was primarily attributable to maturing brokered CD and other time deposit balances that were not replaced.

Balances of time deposits of \$100,000 or more includes brokered CDs, time deposits maintained for public entities, and consumer time deposits. The balance of brokered CDs was \$22.3 million, \$38.4 million and \$42.1 as of December 31, 2006, 2005 and 2004, respectively. The Company also maintains time deposits for the State of Illinois with balances of \$3.1 million, \$3.4 million and \$4.4 million as of December 31, 2006, 2005 and 2004, respectively. The State of Illinois deposits are subject to bid annually and could increase or decrease in any given year.

Repurchase Agreements and Other Borrowings

Securities sold under agreements to repurchase are short-term obligations of First Mid Bank. First Mid Bank collateralizes these obligations with certain government securities that are direct obligations of the United States or one of its agencies. First Mid Bank offers these retail repurchase agreements as a cash management service to its corporate customers. Other borrowings consist of Federal Home Loan Bank ("FHLB") advances, federal funds purchased, junior subordinated debentures and loans (short-term or long-term debt) that the Company has outstanding.

Information relating to securities sold under agreements to repurchase and other borrowings for the last three years is presented below (dollars in thousands):

| | 2006 | 2005 | 2004 |
|------------------------------------------------|------------|------------|------------|
| At December 31: | | | |
| Federal funds purchased | \$ 6,800 | \$ 4,000 | - |
| Securities sold under agreements to repurchase | 66,693 | 67,380 | \$ 59,835 |
| Federal Home Loan Bank advances: | | | |
| Overnight | - | 12,000 | - |
| Fixed term - due in one year or less | 7,000 | 3,000 | 17,300 |
| Fixed term - due after one year | 13,000 | 20,000 | 8,000 |
| Junior subordinated debentures | 20,620 | 10,310 | 10,310 |
| Debt: | | | |
| Loans due in one year or less | - | 5,500 | 4,200 |
| Loans due after one year | 11,000 | - | 400 |
| Total | \$ 125,113 | \$ 122,190 | \$ 100,045 |
| Average interest rate at year end | 5.28% | 4.27% | 2.59% |
| Maximum Outstanding at Any Month-end | | | |
| Federal funds purchased | \$ 6,800 | \$ 4,000 | - |
| Securities sold under agreements to repurchase | 71,516 | 67,380 | \$ 63,517 |
| Federal Home Loan Bank advances: | | | |

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| | | | |
|------------------------------------------------|----------|--------|--------|
| Overnight | 19,500 | 12,014 | 7,000 |
| Fixed term - due in one year or less | 7,000 | 20,000 | 17,300 |
| Fixed term - due after one year | 30,000 | 20,000 | 25,300 |
| Junior subordinated debentures | 20,620 | 10,310 | 10,310 |
| Debt: | | | |
| Loans due in one year or less | 4,500 | 6,200 | 9,025 |
| Loans due after one year | 15,000 | 200 | 400 |
| Averages for the Year | | | |
| Federal funds purchased | \$ 3,432 | \$ 874 | \$ 218 |
| Securities sold under agreements to repurchase | 55,389 | 57,799 | 55,645 |
| Federal Home Loan Bank advances: | | | |
| Overnight | 6,622 | 2,447 | |